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**DEPARTMENT OF AGRICULTURE**

Rural Housing Service

Rural Business-Cooperative Service

Rural Utilities Service

Farm Service Agency

7 CFR Part 1980

Rural Housing Service

7 CFR Part 3555

**RIN** 0575-AC18

Single Family Housing Guaranteed Loan Program

**AGENCIES:** Rural Housing Service, Rural Business-Cooperative Service, Rural Utilities Service, and Farm Service Agency, USDA.

**ACTION:** Interim final rule.

**SUMMARY:** The Rural Housing Service (RHS) is streamlining and reengineering its Single Family Housing Guaranteed Loan Program (SFHGLP) regulation. This action is taken to reduce regulations, improve customer service, achieve greater efficiency, flexibility, and effectiveness in managing the program. The effect of this action is to provide better service to participating lenders and investors by removing Rural Development internal administrative procedures and make the necessary adjustments to reduce SFHGLP risk of loss.

**DATES:** Effective date: September 1, 2014.

Comment date: Written comments on the interim final rule must be received on or before [insert date 30 days from the date of publication in the Federal Register].

**ADDRESSES:** You may submit comments on this interim final rule by any one of the following methods:

- Federal eRulemaking Portal: <http://www.regulations.gov>. Follow the instructions for submitting comments electronically.
- Mail: Submit written comments via the U.S. Postal Service to the Branch Chief, Regulations and Paperwork Management Branch, U.S. Department of Agriculture, STOP 0742, 1400 Independence Ave, SW., Washington, DC 20250-0742.
- Hand Delivery/Courier: Submit written comments via Federal Express mail, or other courier service requiring a street address to the Branch Chief, Regulations and Paperwork Management Branch, U.S. Department of Agriculture, 300 7th Street, SW., 7th Floor, Washington, DC 20024.

All written comments will be available for public inspection during regular work hours at the 300 7th Street, SW., 7th Floor address listed above.

**FOR FURTHER INFORMATION CONTACT:** Debra Terrell, Senior Loan Specialist, Single Family Housing Guaranteed Loan Division, Stop 0784, Room 2250, USDA Rural Development, South Agriculture Building, 1400 Independence Avenue, S.W., Washington, DC 20250-0784, telephone (202) 720-1452 or (918) 331-9404, email is [debra.terrell@wdc.usda.gov](mailto:debra.terrell@wdc.usda.gov).

**SUPPLEMENTARY INFORMATION:**

Executive Order 12866 - Classification

This final rule has been reviewed under Executive Order (EO) 12866 and has been determined to be significant by the Office of Management and Budget. The EO defines a “significant regulatory action” as one that is likely to result in a rule that may:

(1) Have an annual effect on the economy of \$100 million or more or adversely affect, in a material way, the economy, a sector of the economy, productivity, competition, jobs, the environment, public health or safety, or State, local, or tribal governments or communities; (2) Create a serious inconsistency or otherwise interfere with an action taken or planned by another agency; (3) Materially alter the budgetary impact of entitlements, grants, user fees, or loan programs or the rights and obligations of recipients thereof; or (4) Raise novel legal or policy issues arising out of legal mandates, the President's priorities, or the principles set forth in this EO.

The Agency conducted a regulatory impact analysis to fulfill the requirements of EO 12866. In this analysis, the Agency identifies potential benefits and costs of continued homeownership assistance in rural areas. Revising the regulation and creating handbook materials to further detail procedures should lead to improved performance, both by lenders and Agency staff. Ambiguities in program requirements will be eliminated and written guidance in one collective publication will be provided to help lenders and Agency representatives make sound programmatic decisions. Time savings for the Agency should result in a more efficient streamlined delivery of lender guarantee requests and reduced administrative costs to the Agency. Cost savings will be continuous each year and can be measured in terms of Agency staff time, equipment and associated costs. Workload efficiency is also expected to increase by delegating servicer authority to qualified lenders. The regulatory impact analysis estimates the Agency can save over \$14,000 in each dedicated staff time by streamlining the procedures and \$393,000 in staff time for each servicing lender that is delegated authority to approve loss mitigation and property disposition plans. In addition, by revising the requirements for interest on Real Estate Owned properties to allow for property disposition within 90 days of acquisition will save the federal government an estimated \$9.6 million annually.

The analysis also discusses the benefits of changes like the new single close loan feature. The new process will eliminate the need for an interim loan, which will promote new construction in rural areas. Adjustments to qualifications for eligible lenders should also allow more program participation in underserved rural areas.

Other federal assistance is concentrated in urban areas. The disparity between metropolitan homeowners who have financed with federal programs compared to non-

metropolitan rural homeowners indicates the guaranteed program has a positive impact in increasing the level of federal assistance available to low- and moderate-income rural households interested in pursuing homeownership. The impacts of changes to the rule are positive to the federal budget, local economic impact and housing market. Changes are intended to streamline the program, reduce regulations, improve customer service and strengthen the Agency's ability to achieve greater efficiency, flexibility and effectiveness in managing the program. None of the proposed changes is expected to have a significant economic impact on lenders, borrowers, or the U.S. Treasury. The monetary impact of this rule is based on the overall program costs. The estimated overall program costs burden is \$2,200 for applicants/borrowers, and \$125,000 for lender entities. The administrative cost to the Agency for implementation of the rule is approximately \$250,000.

#### **Executive Order 12788 - Civil Justice Reform**

This final rule has been reviewed under Executive Order 12788, Civil Justice Reform. In accordance with this rule: (1) all state and local laws and regulations that are in conflict with this rule will be preempted; (2) no retroactive effect will be given to this rule; and (3) administrative proceedings in accordance with the regulations of the Department of Agriculture National Appeals Division (7 CFR part 11) must be exhausted before bringing suit in court challenging action taken under this rule unless those regulations specifically allow bringing suit at an earlier date.

#### **Unfunded Mandates Reform Act**

Title II of the Unfunded Mandates Reform Act of 1996 (UMRA), Public Law 104-4, establishes requirements for Federal agencies to assess the effect of their regulatory actions on State, local, and tribal governments and the private sector. Under section 202 of the UMRA, the RHS generally must prepare a written statement, including a cost-benefit analysis, for proposed and final rules with “Federal mandates” that may result in expenditures to State, local, or tribal governments, in the aggregate, or to the private sector, of \$100 million or more in any one year. When such a statement is needed for a rule, section 205 of the UMRA generally requires RHS to identify and consider a reasonable number of regulatory alternatives and adopt the least costly, most cost-effective, or least burdensome alternative that achieves the objectives of this rule.

This rule contains no Federal mandates (under the regulatory provisions of title II of the UMRA) for State, local, and tribal governments or the private sector. Therefore, this rule is not subject to the requirements of sections 202 and 205 of the UMRA.

### **National Environmental Policy Act**

We have analyzed this rule in accordance with the criteria of the National Environmental Policy Act (NEPA) (42 U.S.C. 4332(c)), the Council on Environmental Quality’s Regulations for Implementing the Procedural Provisions of NEPA (40 CFR 1500-1508), and 7 CFR part 1940, subpart G, “Environmental Program.” It is the determination of Rural Development that this action is categorically excluded from NEPA documentation requirements consistent with 7 CFR § 1940.310 for financial assistance for the purchase of an existing dwelling. An existing property purchase does not impose a significant

effect on human environment. Therefore neither an Environmental Assessment nor an Environmental Impact Statement is required for this rule.

#### **Executive Order 13132 - Federalism**

The policies contained in this rule do not have any substantial direct effect on States, on the relationship between the national government and States, or on the distribution of power and responsibilities among the various levels of government. Nor does this rule impose substantial direct compliance costs on States and local governments. Therefore, consultation with the States is not required.

#### **Regulatory Flexibility Act**

In compliance with the Regulatory Flexibility Act (5 U.S.C. 601-612) the undersigned has determined that this rule will not have a significant economic impact on a substantial number of small entities. This rule does not impose any significant new requirements on Agency applicants, borrowers or lenders and the regulatory changes affect only Agency determination of program benefits for guarantees on loans made to individuals.

#### **Executive Order 12372 - Intergovernmental Consultation**

This program/activity is excluded from the provisions of Executive Order 12372, which require intergovernmental consultation with State and local officials.

#### **Executive Order 13175, Consultation and Coordination with Indian Tribal Governments**

This executive order imposes requirements on Rural Development in the development of regulatory policies that have tribal implications or preempt tribal laws. Rural Development has determined that the rule does not have a substantial direct effect on one or more Indian tribe(s) or on either the relationship or the distribution of powers and responsibilities between the Federal Government and the Indian tribes. Thus, the rule is not subject to the requirements of Executive Order 13175. Tribal Consultation inquiries and comments should be directed to Rural Development's Native American Coordinator at [aian@wdc.usda.gov](mailto:aian@wdc.usda.gov) or (720) 544-2911.

### **Programs Affected**

This program is listed in the Catalog of Federal Domestic Assistance under 10.410, Very low- to Moderate-Income Housing Loans.

### **Paperwork Reduction Act**

The information collection requirements contained in this interim rule have been submitted to the Office of Management and Budget (OMB) for review and approval.

### **E-Government Act Compliance**

The Rural Housing Service is committed to complying with the E-Government Act, to promote the use of the Internet and other information technologies to provide increased opportunities for citizen access to Government information and services, and for other purposes.

### **Background**



On December 15, 1999, RHS published a proposed rule with request for comments for the Single Family Housing Guaranteed Loan Program (SFHGLP) (64 FR 70123-70144). Rural Development received comments from sixty-three respondents. Comments were from Agency employees or employee groups, lenders, secondary market sources, builders, and various other interest groups.

The 180 day effective date of this rule will allow Rural Development the opportunity to provide training to participating lenders and allow time for computer system changes. Rural Development recognizes the general need to make the program more “user-friendly” and more compatible with existing mortgage lending practices. Many of the comments received addressed these issues.

With this rule, Rural Development is attempting to meld the better features of conventional loan programs and other Government loan programs to make the SFHGLP as easy for lenders to use as possible. Rural Development believes that loan product which is easier for lenders to use will help in increasing the number of rural families served by the program. This approach is supported by Section 706(d) of the Cranston-Gonzales National Affordable Housing Act (Pub. L. 101-625), which provided in developing the guaranteed loan regulations. Rural Development must ensure that guaranteed loans:

- are made in a manner that is cost-effective; and
- reduce, to the extent practicable, the burden of administration and paperwork for borrowers and lenders.

In the past, SFHGLP regulations and instructions have been the same. Lenders participating in the program have criticized this approach as not meeting their needs. This regulation omits the detailed internal agency administrative instructions used to administer the program. Several commenters welcomed the change in the regulatory process.

The Agency will continue to publish all substantive policy that provides a benefit, imposes an obligation on the public, establishes eligibility criteria, or information necessary for members of the public to understand their responsibilities. Rural Development will continue to improve the clarity of the regulations and attempt to meet the needs of the program participants and general public. Any substantive changes in the regulation will continue to be published in the Federal Register and each Agency field office will have a copy of the administrative instruction (a handbook).

The handbook will be available on the Internet at <http://www.rurdev.usda.gov/Handbooks.html> and a copy can be obtained by sending a written request to: Rural Development, Stop 0784, Room 2250, South Agriculture Building, USDA, 1400 Independence Avenue, S.W., Washington, D.C. 20250-0784.

One respondent suggested the public have an opportunity to comment on the handbook. The Proposed Rule provided that the handbook will be available for public comment with regard only to its information collection requirements. The handbook is internal guidance and, therefore, not subject to comment.

Other respondents focused on the lack of detailed administrative instructions. Detailed administrative guidance has been removed from the regulation and is provided in the program handbook.

Several respondents noted that requiring compliance with Year 2000 (Y2K) requirements is dated and suggested removal from the regulations. Rural Development concurs and has removed this requirement.

Specific public comments and substantive changes from the proposed rule are addressed below in general order of appearance in the regulation, not based on order of importance.

#### Purpose (§ 3555.2)

One respondent suggested removal of the reference to “persons who do not own adequate housing” since the rule also provides that current homeowners may obtain loans through the Single Family Housing Guaranteed Loan Program (SFHGLP). The Agency agrees that current homeowners may obtain a SFHGLP loan in certain situations, for example, to make needed repairs to the dwelling. This suggestion is adopted and the reference is removed.

A provision has been added to specifically permit limited demonstration programs as allowed by law. The objective of these demonstration programs will be to test new approaches to financing housing under the statutory authority granted to the Secretary of

Agriculture (hereafter referred as the Secretary). This provision is similar to other Rural Development programs, such as the Section 502 Direct Program, found at § 3550.7.

#### Mediation and appeals (§ 3555.4)

One respondent suggested eliminating mediation and Alternative Dispute Resolution (ADR) stating that neither process works well with the SFHGLP. Rural Development must comply with statutory requirements in 7 U.S.C. 6995 and the National Appeals Division regulation, 7 CFR 11.5, granting participants the right to use available ADR or mediation programs to resolve adverse decisions by the Agency. No change is made in this provision.

#### Environmental requirements (§ 3555.5)

Lenders must comply with all State and local laws and regulations under 7 CFR 3555.6. The proposed rule stated that Rural Development will take into account potential environmental impacts of proposed projects by working with applicants, other Federal agencies, American Indian tribes, State and local governments, and interested citizens and organizations in order to formulate actions that advance the program's goals in a manner that will protect environmental quality. The SFHGLP does not have any provision for working on proposed housing projects. The program guarantees loans made by private lenders to purchase, build, or repair a home. The private lender may be involved in proposed housing projects, however, and would be responsible for compliance with all applicable environmental quality requirements.

Several respondents expressed concern regarding environmental requirements relative to flood insurance. Two respondents were in favor of providing financing in Special Flood Hazard Areas (SFHAs); one stated that there is no risk to Rural Development or lender when proper flood insurance is obtained and one stated that flood insurance should not be required if the site is located in a SFHA but not the dwelling. Four respondents recommended that loans be prohibited if the subject site is located in a SFHA. The National Flood Insurance Act of 1968, specifically, 42 U.S.C. 4012, prohibits Agency-assisted financing of dwellings on a site identified as located in a SFHA when flood insurance is available but has not been obtained on the building and/or personal property associated with the assistance. Rural Development will guarantee loans for existing homes in an SFHA provided the borrower obtains flood insurance at, or prior to, loan closing and maintains flood insurance for the life of the loan. The lender must be listed as a loss payee. Rural Development may guarantee loans for new or proposed homes in an SFHA, even with flood insurance, except under limited circumstances, such as when Federal Emergency Management Agency (FEMA) has issued a Letter of Map Amendment (LOMA) or Letter of Map Revision (LOMR) or if the lender obtains a FEMA National Flood Insurance Elevation Certification indicating the lowest habitable floor (including the basement) of the residential building and all related improvements/equipment are built at or above the 100-year flood elevation. The proposed rule did not contain any provisions for such situations. This change is made to achieve consistency with other Federally insured or guaranteed single-family mortgage programs like those offered by the Department of Housing and Urban Development (HUD) and Veterans Affairs (VA).

#### Enforcement (§ 3555.9)

Language has been added concerning the possible assessment of civil monetary penalties. This penalty is authorized by section 543 of the Housing Act of 1949 (42 U.S.C. 1490s) and 7 CFR 3.91. The Agency does not have a notice and hearing process, as required by the authorizing statute, for the imposition of civil monetary penalties, but the authority has been noted in the rule for future use.

#### Definitions (§ 3555.10)

One respondent stated the term “acceleration” is not a conventional lending term. The term is used in the mortgage lending business, and no change is made in the definition or term.

The term “amortization” was added to describe the gradual reduction of the mortgage debt over the term of the loan.

The term “Area Median Income” was added for clarity to describe the median income in a specific location, as determined by the HUD in order to determine borrow eligibility. This term is used in section 502(h)(3) of the Housing Act of 1949(42 U.S.C. 1472(h)(3)).

The term “condominium project” was added for clarity to describe a particular form of construction development.

The term “combination construction and permanent loan” was added based on a respondent’s comments on 7 CFR 3555.101. More fully explained in (§ 3555.101) of the preamble, a “combination construction and permanent loan” is a guaranteed loan on which the Rural Development guarantee becomes effective at the time construction of an eligible single family housing project begins.

The term “dealer-contractor” was removed since Rural Development will no longer review and approve or disapprove manufactured housing dealer-contractors under the SFHGLP.

The term “escrow account” was revised to clarify a common mortgage industry term for the trust account typically established by lenders to hold funds collected from a borrower in order to pay real estate taxes, insurance premiums, and other similar expenses as they come due.

There were several comments on the definitions for “existing dwelling” and “new dwelling.” These definitions are used in determining property eligibility, inspection, and home warranty requirements. One respondent suggested adding wording that if the dwelling is less than one year old and has been occupied, then it is an existing dwelling. One respondent suggested the wording might be incorrect as it relates to the requirement for the new home warranty. Some respondents suggested alternative wording to the definition of “new dwelling.” One respondent suggested adding “less than one-year old and never occupied.” One respondent suggested permitting financing of spec-built

dwelling without interim construction inspections and without a 10 year, new home warranty if the construction standards exceed the national building code. When the dwelling is less than one year old and has never been occupied, then it is a new dwelling and a new home warranty must be in place. Rural Development agrees that if the dwelling has been occupied, regardless of its age, then it is an existing dwelling, and a new home warranty is not required. The regulation and handbook have been clarified accordingly in response to the comments.

One respondent suggested that the definition for a “first-time homebuyer” should be broadened to include a divorced individual who does not have children, arguing that in most divorces, the wife gets the home if she desires, and can thus argue for custody of the children because the husband does not own a home. The Housing Act of 1949, as amended, provides a definition for a first-time homebuyer. As written in this rule, the definition of first-time homebuyer closely follows the definition in the statute; therefore, no change is made. The Agency notes that the situation provided may fall within this definition depending on other factors, such as if the divorced individual was a homemaker.

The term “Fannie Mae” was added, which is synonymous with the Federal National Mortgage Association.

The term “FHLB” was added as the acronym for the Federal Home Loan Bank.



The term “Freddie Mac” was added, which is synonymous with the Federal Home Loan Mortgage Corporation.

The term “Ginnie Mae” was added, which is synonymous with the Government National Mortgage Association.

The term “loan modification” was added to describe changes to promissory note characteristics such as the interest rate, loan term, and monthly payments.

The term “manufactured home” was changed to more succinctly describe structures built on a permanent chassis according to Federally Manufactured Home Construction and Safety Standards established by HUD and found at 24 CFR part 3280.

The term “moderate income” was amended to include a 2000 statutory change (Pub. L. 106-387, section 751) providing that anyone who does not meet the greater of 115 percent of the U.S. median family income, the average of the state-wide and state non-metro median family income, or 115/80ths of the area low-income adjusted for household size for the county or MSA where the property is, or will be located meets the income eligibility criterion of 42 U.S.C. 1472(h)(2). The definition is consistent with the Agency’s current income policy.

One respondent suggested that the reference to Rural Development’s thermal performance standards be deleted from the definition for manufactured home. Rural

Development agrees that a change to this requirement is needed to be consistent with manufactured housing industry standards and is in the best interest of the program. A change, therefore, is made to this definition to adopt the thermal standard (and other home construction and safety standards) for manufactured housing established by the HUD. These HUD standards can be found at 24 CFR part 3280 or on the internet at <http://www.hud.gov/library/index.cfm>.

Several respondents commented on the definition of “modest housing.” Some suggested removing the reference to section 203(b) of the National Housing Act. Several suggested removal of the reference to in-ground swimming pools as it is not listed as a restriction in 7 CFR 3555.102. Rural Development concurs that, because a SFHGLP loan applicant’s household adjusted income must not exceed the moderate-income limit for the area, the applicant’s repayment ability is the determining factor in ensuring that the modest housing requirements in section 517 of the Housing Act of 1949 are met. This guaranteed loan standard for “modest housing” is different from the Section 502 Direct Loan program which generally defines modest housing as having a market value which does not exceed the applicable area loan and must not have prohibited features. (See 7 CFR 3550.10). For Section 502 Direct loans, the applicable area loan limits are established by each Rural Development State Office, but will not exceed the local HUD 203(b) limit in effect. This difference between the SFHGLP and the Section 502 Direct Loan program is acceptable because of the difference between the programs’ income limits. Applicants for the Section 502 Direct Loan program must have very low or low incomes; a SFHGLP loan applicant’s household adjusted income must not exceed the

applicable moderate-income limit as defined at 7 CFR 3555.10 of this rule. For SFHGLP purposes, the definition of “modest housing” will be the housing that a low- or moderate-income borrower can afford based on their repayment ability.

The low- or moderate-income applicant’s repayment ability will be the determining factor in ensuring that the modest housing requirements in section 517 of the Housing Act of 1949 are met. The reference to section 203 (b) of the National Housing Act is removed from the regulation. This is permissible since eligible housing for the SFHGLP need not be eligible under that statute according to section 502(h) (4) (B) of the Housing Act of 1949.

The term “mortgage credit certificate” was amended to fully describe a Federal tax credit which reduces a borrower’s Federal income tax liability and improves his or her repayment ability.

The term “MSA (Metropolitan Statistical Area)” was added as it is a term the Office of Management and Budget has prescribed for use by Federal agencies to collect, tabulate, and publish Federal statistics.

The term “new dwelling” was amended to achieve consistency with other Agency program regulations and to better conform to widely accepted mortgage industry standards. A dwelling that has been completed for more than one year and that has never been occupied is considered an existing home.

The term “pre-foreclosure sale” was added to describe a loss mitigation technique which reduces the cost of liquidating a property the lender is considering for a foreclosure.

The term “primary residence” was added, which is synonymous with the term “principal residence.”

The term “principal residence” was added as it is the language included in the Housing Act of 1949, as amended, to describe eligible housing. For the property to be eligible, it must be a single family dwelling, must be modest, located in a rural area, and be used by the borrower as their principal residence.

The term “qualified alien” was amended to achieve a more complete description consistent with Section 401 of the Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (PRWORA) at 8 U.S.C. 1641, which describes the class of non-U.S. citizens who are eligible for Federal assistance in the form of a loan, grant, or guarantee.

Two comments were received on the definition for “rural area.” Both respondents suggested expanding the population base arguing that doing so would make the program more competitive and reduce lender confusion. These comments are beyond the scope of this regulation as section 520 of the Housing Act of 1949 defines the term. The Agency has no authority for expanding the population base for Single Family Housing programs

as suggested. The definition in this rule has been updated to refer to section 520 of the Housing Act, as amended.

The term “settlement date” was added to clarify when additional interest on an unsatisfied principal balance begins to accrue for loss claim payment purposes under 7 CFR 3555.352. The definition takes into account certain state-required redemption or confirmation periods, as well as general industry standards and loss mitigation techniques. Therefore, the settlement date, for the purpose of calculating a loss payment, is the later of the actual foreclosure date, the closing date if the property sold to a third party at the foreclosure sale, the date the borrower with lender concurrence sold the property to a third party in order to avoid or cure a default situation, and when title is acquired to the security following the expiration of any state-required redemption or confirmation period.

The term “short sale” was added to describe a loss mitigation technique which reduces the cost of liquidating a property the lender is considering for a foreclosure.

The term “SFHGLP” was added as the acronym for the Single Family Housing Guaranteed Loan Program of USDA, Rural Development that is authorized under section 502 of the Housing Act of 1949, as amended.

The term “U.S. non-citizen national” was added to be consistent with Section 341(b)(2) of the Immigration and Nationality Act, 8 U.S.C. 1452(b)(2) to describe a class of

applicants who may be considered eligible for Federal assistance in the form of a loan, grant, or guarantee.

The following terms are introduced in § 3555.10 as a result of the addition of a new section § 3555.304 regarding special servicing options “Extended-term loan modification,” “Maximum allowable interest rate,” “Mortgage payment to income ratio,” “Mortgage recovery advance,” and “Total debt to income ratio.”

#### Lender eligibility (§ 3555.51)

Several respondents expressed interest in this section. Some expressed concern regarding the lender eligibility requirement to underwrite and service single family housing loans and questioned whether lenders presently approved and not meeting these conditions will be permitted to continue as approved lenders. Lenders who no longer meet the requirements, however, will cease to be eligible to participate, as has been the case in the past under 7 CFR 1980.309(h). Since categories of eligible lenders are being expanded, however, eligible lenders should increase not decrease. The same respondents indicated the requirements of meeting HUD’s direct endorsement authority as a supervised or non-supervised mortgagee are too strict, citing that some rural lenders would not meet the net worth requirements. The conditions outlined for lender approval are the same as currently in place, but with some modification to expand eligibility while maintaining the integrity of the program. The requirements have been expanded to include as eligible those lenders supervised by Federal regulatory entities, or which are Government sponsored enterprises. Acceptable Federal supervisory entities which have been added

for eligibility purposes include the Federal Deposit Insurance Corporation, the Federal Reserve System, the National Credit Union Administration, the Office of Thrift Supervision, the Office of the Comptroller of the Currency, and the Federal Housing Finance Board. The latter regulates banks within the Federal Home Loan Bank (FHLB) System. These Federal entities supervise their lenders, impose capital and net worth requirements, and periodically conduct audits and examinations of the lenders for the purposes of safety, soundness, and compliance with their Federal requirements. Rural Development believes these requirements will protect the integrity of the program and promote loan quality. The final rule is amended accordingly.

One respondent noted the proposed rule omitted default and status reporting from the regulations. 7 CFR 3555.51 (b) (8) requires the lender to cooperate with Agency reporting requirements. This reference includes both monthly default and quarterly status reporting, etc. as specified in the Agency handbook. The handbook guidance uses the industry standard for investor and guarantor reporting requirements. Specifically, investor and guarantor reporting are now done through an Electronic Data Interchange (EDI) or other electronic methods. The lender's agreement also provides for reporting requirements as needed to monitor lender performance. As a related issue, the Agency has noticed that not all sales, transfers, or change of servicers are reported to the Agency in a timely manner. The Agency is not able to track the performance and status of the Guaranteed portfolio unless lenders report all sales, transfers or changes in servicers; hence, the language in 7 CFR 3555.51(b)(10) has been changed to specifically list these existing requirements.

Other respondents were concerned about Rural Development requiring a fidelity and omissions policy listing Rural Development as loss payee. Rural Development has reviewed this proposal and determined that it is not consistent with the mortgage industry and agrees to remove. To be eligible, the lender must have a demonstrated ability to underwrite and service single-family loans and must meet standards established by a Government Sponsored Enterprise (GSE) or a similar organization or Federal entity. The fidelity and omissions policy requiring Rural Development to be listed as a loss payee, therefore, is not needed to protect the Government.

One respondent recommended establishing a delinquency goal to improve and monitor a lender's servicing performance. While Rural Development agrees that the performance of the serviced portfolio is important, we believe that a delinquency goal in itself is not adequate to assess lender performance. Further guidance regarding acceptable overall lender performance and Agency monitoring procedures are addressed in the handbook. Lender participation requirements are covered in subpart B of this part. No change has been made in response to this comment.

One respondent inquired as to why Ginnie Mae was not included as an eligible entity to purchase guaranteed loans. Ginnie Mae is not a holder of loans, but acts on behalf of a holder by guaranteeing "pools" of securitized loans in case of default. Ginnie Mae does not purchase individual loans. Therefore, no change has been made in response to this comment.



One respondent expressed a concern regarding the amount of paperwork and materials to be submitted by the lender to Rural Development and the extent to which Rural Development reviews or underwrites the loan. Lenders currently have sole responsibility for underwriting the loan and will continue to assume this responsibility with implementation of the final rule. Rural Development, however, reviews the loan for program compliance prior to issuing a Conditional Commitment. The loan submission and review process is covered in 7 CFR 3555.107 and is detailed more extensively in the handbook.

#### Lender approval (§ 3555.52)

For several years, Rural Development has required that lenders undergo an online training that is available on demand in order to become an approved lender. This requirement has been stated in the rule.

Provisions proposed describing possible suspension and debarment proceedings after termination or withdrawal of lender approval have been removed from the final rule, as unnecessary since it is covered by separate regulations, 2 CFR parts 180 and 418. This section has been clarified to state that any termination of approval will be conducted in accordance with the terms of the lender's agreement. The Agency may take any corrective action or seek any remedy authorized by law.

#### Loan purposes (§ 3555.101)

Several respondents requested clarification on reasonable and customary expenses related to obtaining the loan, recommending that the regulations be more specific on allowable fees and charges. One respondent stated that they support Rural Development's objective to eliminate blatant excesses and abuse by lenders in this area, but that the dynamics of the free market economy would be the best check against excessive lender fees and charges. Rural Development supports the benefits provided to SFHGLP loan applicants due to market competition, but recognizes that the SFHGLP is different than most other programs in that the program permits long-term financing of most, if not all, closing costs charged by the lender. Not only is the SFHGLP borrower negatively affected by excessive fees and charges, Rural Development pays higher claims on defaulted loans than necessary when excessive fees and charges are financed in the mortgage loan. Rural Development, therefore, has clarified this section to state that reasonable and customary closing costs include lender fees and charges that do not exceed those charged other applicants by the lender for similar types of transactions. For many lenders, the most similar type of transaction is another housing loan with Federal insurance or guarantee. Lenders that do not participate in other government insurance or guarantee programs may use for comparison a loan program that has conventional insurance or guarantee. Lenders will ensure that their fees and charges meet these requirements and will make their records available upon request.

Other respondents suggested a change to allow discount points as a permissible loan purpose for moderate-income applicants. Discount points are paid to obtain a lower interest rate. Rural Development disagrees that moderate-income applicants should be

allowed to finance the cost to “buy down” the interest rate. The need to obtain a lower interest rate by paying additional points is less acute for moderate-income applicants than for low-income applicants, and not paying discount points keeps financed closing costs at a lower level. The treatment of discount points remains the same as under the prior regulation. The proposed provision that allows only low-income applicants to include reasonable discount points in their loan amount therefore, remains unchanged.

Based on comments received and Rural Development’s belief that homeownership education is a worthwhile expense for all homebuyers, Rural Development has elected to continue to allow the payment of homeownership education fees from loan funds. The restriction of this coverage to first-time homebuyers has been removed.

One respondent suggested adding ovens, wall-to-wall carpeting, flooring, heating and cooling equipment to 7 CFR 3555.101 (b) (5) to be consistent with those purposes stated for manufactured housing. In 7 CFR 3555.101, paragraph (b) had been revised and paragraph (c) has been redesignated. The suggested items have been included in the newly revised paragraph (b)(1).

One respondent suggested a “one-time close” provision for combined construction to permanent loans. Rural Development has been testing such a program, agrees with the respondent, and includes a provision for combination construction and permanent financing as an acceptable loan purpose in the final rule. Conditions for such loans are listed in newly revised 7 CFR 3555.105. The criteria for a “one-time close” provision

reflect those that have been successfully tested by Rural Development and are substantially similar to comparable “one-time close” programs already prevalent in the mortgage industry today. The following limitations reduce the risk to the Government on these projects. Lenders must have at least two years of experience making and administering construction loans and will be responsible for reviewing and approving construction contractors or builders, including due diligence such as conducting background checks, ensuring the builder has two or more years of experience in constructing single family dwellings, and that the builder possesses the appropriate licenses, insurances, etc. As is the case with similar combined construction to permanent loan programs in the mortgage industry today, lenders will finance the price of the lot as well as reasonable and customary closing costs, and loan proceeds will be escrowed and funds paid out in draws during construction. Draws clarify for the builder and borrower when and how payment will be made during the construction period. Once construction is complete, the loan will be modified and re-amortized to achieve full repayment within the loan’s remaining term, not to exceed 30 years. Rural Development reserves the right to limit the number of loans guaranteed under this section based on market conditions and/or loan performance.

Some respondents suggested that the regulations should be revised to permit refinancing of existing Section 502 guaranteed and direct loans with Section 502 guaranteed loans.

At the time the proposed rule was published, Rural Development did not have the statutory authority to refinance existing Section 502 direct and guaranteed loans.

However, Rural Development now has the statutory authority to do so under 42 U.S.C.

1472(h)(14). The regulation is revised accordingly in § 3555.101(d) to incorporate the Agency policy on refinancing existing Section 502 direct and guaranteed loans. For these types of refinancing, the interest rate must be fixed and least 100 basis points below the original loan rate; the security must be the same property as for the original loan which still serves as the principal residence for the borrower; the borrower must have kept the account current for at least 180 days prior to application for refinance; borrowers may be deleted and qualified borrowers may be added; and the new loan amount cannot exceed the balance of the existing loan, interest, guarantee fee and reasonable closing costs.

Borrowers with existing guaranteed loans may use a streamlined option for refinancing, which does not require a new appraisal. Borrowers with existing direct loans must use the non-streamlined option and obtain a new appraisal, because direct loans are subject to recapture and the recapture calculation requires a current appraisal value.

Documentation, costs and underwriting requirements of subparts D, E, and F of this part apply to refinances, unless otherwise provided by the Agency. Given housing market fluctuations, the Agency needs to be capable of reacting quickly to changing housing needs. The Agency may limit the number of guaranteed loans made for refinancing purposes based on market conditions and other appropriate factors in accordance with section 502(h)(17)(f) of the Housing Act.

One respondent recommended correcting 7 CFR 3555.101(c) (2) (iii) to read that refinancing is permitted in the case of a loan for a site without a dwelling if a dwelling “will be” constructed on the site. Rural Development concurs and the regulation is so clarified.

#### Loan restrictions (§ 3555.102)

One respondent questioned whether the intent of 7 CFR 3555.102(b) was to require a determination whether the applicant intends to use the land or buildings for a business. The intent of the regulation is to prohibit guaranteeing loans to purchase land or buildings typically used primarily for income-producing purposes and the section has been revised for clarification.

One respondent encouraged Rural Development to establish a maximum amount for property seller financing concessions to prevent over-inflated property values. This change is adopted, and the regulations have been revised to state that the property seller, or other interested party, may contribute up to 6 percent of the property's sale price toward the purchaser's financing costs. The 6 percent provision is consistent with present HUD guidelines. This amount may change periodically based upon the performance of the portfolio, changing mortgage industry standards, and the level of exposure the Agency is willing to assume to excess risk by creating incentives which may increase the appraised value of a property.

#### Maximum loan amount (§ 3555.103)

No comments were received on this section; however, the section has been re-written to clarify that the maximum loan amount cannot exceed the lesser of the market value of the property as determined by an appraisal that meets Agency requirements plus the amount of the loan guarantee fee required by newly redesignated 7 CFR 3555.107(f), or the total

of the purchase price and all eligible acquisition costs as permitted by 7 CFR 3555.101. The change was made to account for statutory authorities granted after the proposed rule was published. 42 U.S.C. 1472(h)(7)(C) includes the ability to exceed a 100 percent loan-to-value to the extent that the guarantee fee is included in the loan amount, and no longer references HUD loan limit restrictions under section 203(b) of the National Housing Act.

The proposed rule inadvertently omitted language limiting the maximum loan amount to 90 percent of the present market value for new construction when the requirements of § 3555.202(a) regarding plan certifications, inspections and warranties cannot be met. The final rule corrects this omission and contains language substantially similar to that in current regulations, 7 CFR 1980, part D.

#### Loan terms (§ 3555.104)

Several comments were received on the proposal to establish a maximum interest rate allowable for the SFHGLP and the method of notification to participating lenders. Some respondents suggested letting the market set the rate while others commented that a maximum rate should be established due to limited competition in rural areas. Others were concerned that establishing the rate cap at 125 basis points over the Fannie Mae 90-day rate would be detrimental to the applicants and ultimately to Rural Development in higher default and loss rates. Most of the respondents agreed there must be flexibility in the rate and, that changes to the rate not disrupt the lender community or secondary market. After full consideration of the comments and the issues and risks involved, Rural

Development agrees that the rate can be based on market competition, but that there should be a maximum interest rate to protect borrowers who may not be very experienced with mortgage financing. Permitting the lender to establish the interest rate by means of publishing a VA rate is objective, not subjective, so the proposed provision to establish the Rural Development rate was removed from the final rule. Substantially consistent with the proposed rule, the interest rate may be established based on market competition, provided the rate does not exceed the greater of:

- the current Fannie Mae posted yield for 90-day delivery (actual/actual) for 30-year fixed rate conventional loans plus 1 percent, rounded up to the nearest one-quarter of 1 percent.
- the current Freddie Mac required net yield for 90-day delivery for 30-year fixed rate conventional loans plus 1 percent, rounded up to the nearest one-quarter of 1 percent.

Previously, only mortgages with 30-year terms were permitted. Lesser loan terms may be used as Rural Development completes changes to its systems and subsidy rate models in order to accommodate loan terms of less than 30 years. Under the Housing Act of 1949, as amended, loan terms may be up to 30 years, but not greater.

Updates to the interest rate limits are available in any Rural Development State Office or online at <http://www.rurdev.usda.gov/regs/regs/pdf/04401.pdf>.

Interest assistance (§ 3555.105) and Recapture (§ 3555.106)



A suggestion was made to remove requirements from the regulation since the interest assistance program is not funded nor is funding proposed. Since there are fewer than 50 outstanding loans receiving this assistance, the suggestion was adopted and a decision was made to include these policies in the handbook to continue administering existing interest assistance obligations. 7 CFR 3555.105 has been revised and 7 CFR 3555.106 has been reserved.

#### Application for and issuance of the loan guarantee (§ 3555.107)

Three respondents addressed concerns regarding issuance of the conditional commitment. All three recommended that in order for borrower costs to be reduced and the loan process to be efficient and streamlined, property inspections, such as a well test or construction phase inspections must be treated as conditions to loan closing. Rural Development does not intend that a borrower incur unnecessary costs prior to issuance of the conditional commitment, and has clarified the regulations to state that the lender may obtain evidence of required property inspections not needed for environmental compliance and any necessary repairs after issuance of the conditional commitment, but prior to submitting the request for the loan guarantee.

Some respondents requested clarification on the amount of the guarantee fee. By statute, the up-front guarantee fee must be based on the principal loan amount obligated. (See 502(h)(8) of the Housing Act of 1949.) If the up-front guarantee fee is included in the loan amount, the loan amount increases along with a corresponding increase to the fee.

Assuming for illustration purposes that the guarantee fee is 2 percent, the following formula applies:

$\text{loan amount} \div 0.98 = \text{loan amount, including guarantee fee}$

e.g.  $\$100,000 \div 0.98 = \$102,2040.82$  (includes the guarantee fee)

Rural Development will provide additional comprehensive examples of how to calculate the guarantee fee in the handbook.

In addition, Rural Development added in this section that, when a shortage of funds is projected or anticipated during the fiscal year, funding will be restricted to first-time homebuyers or veterans. This is consistent with sections 502(h)(5) and 507 of the Housing Act of 1949, as amended, which gives priority to first-time homebuyers and veterans. A determination that a shortage of funds will be made if, based on current obligation rates, funds will be projected to run out before the end of the fiscal year.

Note that an annual fee is now authorized by Section 201 of Public Law 111-212, 42 U.S.C. 1472(h)(8). Under that statute, the Secretary is authorized to collect from the lender an annual fee not to exceed 0.5 percent of the outstanding principal balance of the loan for the life of the loan. The Agency published a final rule regarding the annual fee on July 11, 2012 in the Federal Register (77 FR 40785). The intent of the annual fee is to make the SFHGLP subsidy neutral, thus eliminating the need for taxpayer support of the program. The annual fee will be applicable to purchase and refinance loan transactions.

The paragraph on proper closing (§ 3555.107(i)) has been revised to clarify the Agency's policy in allowing "self-certified" lenders to submit minimal documentation to evidence a properly closed loan. To obtain "self-certification" authorization from the Agency, the lender must actively originate SFHGLP loans and have demonstrated consistent successful loan closings with full documents. Self-certified lenders must still submit the promissory note and settlement statement to the Agency.

#### Full faith and credit (§ 3555.108)

The proposed regulations inadvertently omitted a section explaining the "Full faith and credit" provisions of the Loan Note Guarantee. The final rule corrects this omission and contains language substantially similar to that in the current regulation. New language in this section introduces indemnification when a lender fails to originate a loan in accordance with the requirements in this subpart and possible action the Agency may take as a result of that determination. The proposed rule did not contain language regarding indemnification. This language is added as a result of a final rule published May 31, 2011 (76 FR 31217-31220).

#### Eligibility requirements (§ 3555.151)

Three respondents suggested bringing underwriting standards regarding credit reports, credit scores, and repayment ability in line with the private industry. Certain organizations such as VA, Fannie Mae, Freddie Mac, and others in the mortgage industry have instituted a single debt-to-income ratio requirement of 41 percent for low-or-no-down payment affordable housing loans. The Agency is concerned that if a single ratio

of 41% were adopted, the potential is that a borrower with limited income may be permitted to have mortgage payments of up to 41 percent of their income if they happened to apply during a debt free timeframe. The concern is that the borrower would be fully encumbered by their mortgage payment and would become over extended if faced with the need for a new car loan, for example. However, the Agency will maintain its current policy of using a dual ratio approach – a monthly housing expense ratio of 29 percent or less and a total debt-to-income ratio of 41 percent – until sufficient data analysis permits the adoption of the single ratio approach and the Agency determines that a single debt ratio approach is prudent given current market conditions. The Agency reserves the right to adopt the single ratio approach once data analysis supports that a single debt ratio approach does not incur more risk.

Other respondents recommended that the maximum debt to income ratio for repayment ability be raised for loans to purchase energy-efficient homes, such as loans to purchase homes built to energy-efficient standards. The respondents indicated it is industry standard to allow for increased debt ratios on energy-efficient home loans. HUD, VA, Fannie Mae, and Freddie Mac all allow for increased debt ratios for energy-efficient home loans. The rationale is that energy-efficient homes cost less to heat and cool, and the reduced costs make a higher mortgage payment may be more affordable to the borrower. Rural Development agrees some flexibility may be warranted when purchases involve homes built to energy-efficient standards. Further guidance surrounding flexibilities for increased debt ratios for energy-efficient home loans will be addressed in the handbook. Energy efficient homes are properties which are built or retro-fitted to the

standards of the most recent International Energy Conservation Code (IECC) are widely regarded in the mortgage industry as energy-efficient. Rural Energy Plus provisions are further described in newly designated 7 CFR 3555.209. Lenders will certify that the most recent IECC standards have been met.

Aside from energy-efficient housing, one respondent suggested it be left up to the lender to decide when to make debt ratio exceptions above the established threshold. The respondent indicated that throughout the mortgage industry the decision to make debt ratio exceptions are up to the lenders who document compensating or mitigating factors. The Agency agrees with the respondent that debt ratio exceptions are acceptable when supported by acceptable compensating factors. Further guidance on acceptable compensating factors and flexibility of a lender to make a decision regarding an increased debt ratio will be addressed in the handbook.

Several comments were received in support of Rural Development's current acceptance of alternative documentation for income verification, specifically, the use of online resources to document employment history and income. This method of verification is now generally accepted in the mortgage industry, including Rural Development. The proposed rule did not specify methods to verify income and employment, and neither is it necessary in the final rule. Since reputable online resources can change from time to time, however, guidance pertaining to electronic verification of income and employment is provided in the handbook.

One respondent suggested that the program's income limits are too low to assist many first-time homebuyers who have been unable to acquire sufficient savings for the down payment required by other mortgage programs, and that the limits need to be increased to keep pace with the cost of living. Section 502(h)(3) of the Housing Act of 1949 governs SFHGLP income limits, and Rural Development lacks the authority to increase income limits specifically to meet the needs of more first-time homebuyers. Thus, the Agency has made no changes.

Several comments were received on the eligibility of current homeowners to obtain guaranteed loans. Some respondents argued that if the applicant currently owns housing, then approval of a SFHGLP loan should not be considered. Others suggested that the current home should be sold prior to issuance of the Loan Note Guarantee. Still, others viewed the proposed change to allow current homeownership, as long as the homeowners do not own nor are financially responsible for another home at the time the loan closes, to be positive and stated the change would allow more homes on the market for lower income families and remove the confusion regarding a deficient housing determination. Rural Development agrees that the proposed provision might prevent some applicants from obtaining homes that meet the needs of the household. The Agency, therefore, will allow current homeowners to use the program, provided: (1) they do not have another SFHGLP or Section 502 Direct Loan by the time of closing; (2) they are financially qualified to own more than one house; (3) retaining ownership of a home is limited to one single dwelling unit per household other than the one associated with the current loan request; (4) they will occupy the home financed with the SFHGLP loan as their primary

residence; (5) the current home no longer adequately meets the family's needs, and (6) they are without sufficient resources or credit to obtain the dwelling on their own without the guarantee. This change is being made to enable an eligible qualified homeowner to use the SFHGLP loan program to obtain a new primary residence that the applicant believes will meet the household's needs, while ensuring that limited program funds are used within statutory authorities to assist as many qualified individuals as possible.

Four respondents commented on funded buydown accounts. One stated that the proposed rule provided a much needed definition for buydowns. Two suggested eliminating funded buydowns from the regulations stating they are not beneficial to the applicant and may encourage inflated appraisals to cover the property seller's cost of the buydown. One respondent suggested training be required. Rural Development believes that funded buydowns can be used to assist qualified applicants to qualify for home loans and temporary interest rate buydowns are a financing tool designed to reduce the borrower's monthly mortgage payment during the early years of repayment. The Agency feels the proposed SFHGLP limitations provide adequate protection against inflated appraisals. In response to these comments, the final rule has been changed to require that a lender qualify the applicant at the note rate, rather than qualify the applicant at the temporary reduced rate, to ensure the eventual increase in mortgage payments will not affect the borrower adversely and lead to default. The mortgage industry generally accepts this approach. All remaining provisions of the preliminary rule remain unchanged. Rural Development will provide training to Agency staff and lenders upon implementation of these regulation changes.

Several comments were received on credit qualifications. Some respondents expressed a concern that increasing late payments from 1 to 3 or more late payments within the last 12 months would have a potential negative impact on delinquency rates even though the change could possibly qualify an increased number of applicants. Rural Development carefully considered the comments, and in recognition of the mortgage industry's utilization of credit scores that consider the number of late payments, has changed the regulation to incorporate the use of credit scores instead of all of the separate indicators of unacceptable credit as proposed. Rural Development SFHGLP performance and mortgage industry statistics show that credit scores are a powerful indicator of the likelihood for borrowers to be successful homeowners. Credit scores take into account all the separate indicators of credit in a credit report and encapsulate them into one score. Credit scores are widely used throughout the mortgage industry and very few loan programs, if any; do not make use of them. 7 CFR 3555.151 requires a credit score or other credit qualifications satisfactory to Rural Development to show the applicants' reasonable ability and willingness to meet their debt obligations. Further information on credit scores can be found in the handbook consistent with current Agency practice.

Several comments were received on proposed § 3555.151 (h) (1) (viii) relative to payment of collection accounts within 6 months of filing an application. The respondents viewed this change as negative as it requires the applicant to wait 6 months after paying a collection in full before making application for a loan. One respondent noted that credit issues should be guidelines and provide the lender some flexibility to look at



compensating factors. Rural Development decided to remove this requirement from the regulation and rely on the use of credit scores and other credit qualifications to determine credit-worthiness, within statutory requirements. Rural Development has provided examples of evaluating credit in the handbook.

Rural Development proposed to make homeownership education mandatory for all first-time homebuyers. Several respondents posed questions and concerns regarding this proposal. Some respondents believe homeownership education has little or no bearing on the success of the loan, but does increase the cost of homeownership. These respondents believe that past credit history is more important in assessing future success. Still others indicated that if Rural Development requires mandatory education, that Rural Development provides a specific curriculum and evaluation criteria or consider providing the education which would alleviate the current subjective process used by lenders. Some respondents indicated there is a lack of providers in rural areas that could result in additional program barriers by delaying closings and imposing excessive travel to obtain such services. In view of the comments received, language surrounding homeownership education will remain consistent with conditions outlined for homeownership counseling currently in place.

Section 3555.151(j) states that eligible applicants be unable to secure conventional credit elsewhere without a guarantee. This policy was adopted in the early 1990's and since that time a number of loan vehicles have emerged that are marketed as "conventional," but have incorporated features that add to the potential risk of loss to applicants, such as allowing unreasonably low down payments and higher debt ratios. Some of these loans

are called interest-only payment loans, graduated payment loans, negative amortization loans, and balloon payment loans. They may require private mortgage insurance. To clarify the meaning of “conventional credit” for purposes of the SFHGLP and distinguish it from the new, non-traditional mortgage products that claim to be “conventional,” the final rule uses the term “traditional conventional credit.” The Agency currently interprets “traditional conventional credit” as a loan that has a 30-year fixed term, does not require private mortgage insurance, and where the applicant: (1) is able to make a 20 percent down payment from personal funds; (2) able to pay all closing from personal funds; (3) has a total debt ratio of 36 percent or less; (4) has a debt ratio for principal, interest, taxes and insurance of 28 percent or less; and (5) has a good credit history consisting of at least two credit bureau trade lines open and paid as agreed for at least a 24-month period.

#### Calculation of income and assets (§ 3555.152)

Rural Development has provided clarity in § 3555.152(a)(1) and (a)(2) for income calculation. For determining repayment income, the lender must examine the previous 2-year history of the applicant’s income, as well as make a determination as to whether the income is likely to continue for at least the next 3 years. These requirements do not mean that an applicant had to maintain the same employment and earn the same amount of income for the past 2 years. The requirement merely provides a reasonable period of time over which the lender must examine the applicant’s past income in determining repayment ability for the future and aligns the analysis of repayment income with other Agency programs and industry practice. For annual income the lender must examine the

2-year income history for each household member. Lenders must also estimate the expected income for the next 12 months for each household member.

Lenders may also consider the training and education of applicants in determining the continuity of income, as noted in § 3555.152(a)(1). The consideration of training and education would be most applicable to newly graduated students, or students who have completed and obtained technical degrees in various fields and are entering the workforce. While these students may not have a history of employment in their respective fields, their training and education, combined with a contract for hire, may be used to determine the stability of continuity of their income.

One respondent suggested that proposed § 3555.152 (c) regarding adjusted income be revised to show an increase to the \$480 deduction for each family member under 18 years of age or 18 years of age or older with a disability, or a full-time student to reflect inflationary increases of the last 10 years and to be consistent with the Internal Revenue Service allowance for dependents. Rural Development's authorizing legislation does not permit a change in this amount. This deduction for dependents is required by HUD regulation 24 CFR 5.611. No change is made to this provision.

Language was added to the final rule specifically exempting income received by live-in aides from the annual income calculation. A live-in aid is a hired employee, not a household member, whose income is not typically applied to household expenses.

Accordingly, income received by a live-in aid will not be included in the annual income calculation. This is consistent with 24 CFR 5.609.

Three comments were received on proposed § 3555.152 (d) concerning the calculation of income from net family assets for eligibility purposes. Two respondents indicated the requirements should be eliminated as it imposes a penalty on those applicants who manage their resources and then have it count as income. One respondent recommended implementation as proposed. Rural Development's authorizing legislation, Title V of the Housing Act of 1949, as amended, requires the calculation of income according to HUD authorities. See the definition of "income" in 42 U.S.C. 1471(b)(5). HUD authorities require consideration of family assets in income. See 42 U.S.C. 1437a(b)(4) and 24 CFR 5.609. This section, therefore, will be adopted as proposed.

#### Site requirements (§ 3555.201)

One respondent indicated that prohibiting the presence of small barns on properties would eliminate from consideration many homes which would otherwise qualify, and that small barns are commonplace on many residential properties in rural areas. The regulation has been revised to clarify that vacant land or property used primarily for agriculture, farming or commercial enterprise is ineligible. This language will allow small outbuildings which are not designed to accommodate a business or income-producing enterprise may be included in the site. Only income-producing land or buildings intended to be used principally for income-producing purposes are not permitted. Further guidance will be outlined in the handbook.

The requirement that the site value not exceed 30 percent of the value of the property was removed from the final rule because it is no longer a mortgage industry standard. This matter is typically better addressed under State or local government zoning ordinances which must be met.

#### Dwelling requirements (§ 3555.202)

Two respondents discussed concerns about the proposed requirement that 150 percent of development funds be placed in escrow for incomplete exterior development. Both respondents argued that Rural Development should require only 100 percent of the funds for development is placed in escrow stating that the change would permit the lender to pay out the property seller and still protect the applicant. Rural Development agrees that this adequately protects the Government and will permit the lender to place only 100 percent of the funds for final development in escrow.

The final rule similarly covers instances when there is incomplete interior development that cannot be completed until after the borrower takes title to the property. The time to complete all unfinished development was expanded from 120 to 180 days in order to accommodate delays due to inclement weather which in parts of the country can interfere with construction for extended periods of time.

The final rule has been revised in regard to minimum thermal efficiency requirements for homes financed with guaranteed loans. New homes are typically built in accordance with

local housing codes that address thermal efficiency standards. The thermal efficiency of existing homes is typically considered in the valuation process but cannot always be determined accurately. The cost to alter an existing home to meet Agency thermal standards is not always cost-effective. The final rule eliminates minimum thermal efficiency requirements for existing homes financed with guaranteed loans. Note that, properties which are built or retro-fitted to the standards of the most current IECC are widely regarded in the mortgage industry as energy-efficient and permit applicants to qualify at a higher debt ratio of 43 percent.

Manufactured homes must conform to the Federal Manufactured Home Construction and Safety Standards (FMHCSS) and be constructed in compliance with the HUD's heating and cooling requirements for the State in which the unit will be located. The final rule is consistent with other federally insured or guaranteed single-family mortgage programs. The requirement that the property be free of termites and other wood damaging pests and organisms was removed from the final rule because these issues today are addressed by State and local governments.

#### Ownership Requirements (§ 3555.203)

A change was made to the final rule concerning secured leasehold interests, to accommodate leases on American Indian restricted land which are for periods of 25 years and which are renewable for a second 25-year period. Such leases are permissible.

#### Special requirements for condominiums (§ 3555.205)

Several respondents questioned the requirements for condominiums. The proposed rule states that loans may be guaranteed for condominium units in condominium projects that meet the project acceptance criteria established by HUD, VA, Fannie Mae, or Freddie Mac. Rural Development has elected to not restate the project acceptance criteria of HUD, VA, Fannie Mae, or Freddie Mac in program regulations, but has included administrative guidance for this issue in the handbook. This represents no change from Agency current practice. For further background information, the following websites may prove useful:

[http://www.freddiemac.com/sell/factsheets/condo\\_projects.html](http://www.freddiemac.com/sell/factsheets/condo_projects.html);

<https://www.efanniemae.com/sf/index.jsp>; and <http://www.hudclips.org/cgi/>.

#### Special requirements for community land trusts (§ 3555.206)

Some respondents argued that Rural Development should prevent terminating the land trust restrictions when the property is foreclosed. The respondents recommended the section be amended to allow a mortgage on the dwelling only and, thereby, keeping the restrictions in place upon forced sale of the dwelling. Removing or amending the requirement of terminating land trust restriction upon foreclosure would adversely affect the market ability of the property, thereby increasing the loss to the Government. Therefore, no change is made to the final rule.

#### Special requirements for manufactured homes (§ 3555.208)

Several respondents suggested Rural Development thermal standards not be required for manufactured housing. Based on these comments, the requirement related to thermal standards is revised to adopt the standards established by HUD, as discussed above.

Construction must conform to the FMHCSS and HUD heating and cooling requirements for the State.

Others suggested accepting the manufacturer's warranty and not requiring any additional dealer warranty. After considering this comment, Rural Development decided to remove the requirement for Agency-approved dealer-contractors because no other Government insurance or guarantee program has a similar requirement, and because Rural Development's interest will be adequately protected under the warranty provisions of the final rule. This change also reduces the administrative burden and cost for lenders and borrowers while still protecting the Agency's interests. Agency warranty requirements will remain in place in order to ensure that the borrower's new manufactured home is warranted against manufacturing defects, damage incurred during transport from the dealer to the site, and defects related to faulty installation on the permanent foundation.

#### Required servicing actions (§ 3555.252)

Several comments were received on the proposal to permit the participation of some lenders that do not utilize tax and insurance escrow accounts. Six respondents disagreed with the proposal, stating that lenders that lack the means to escrow should not participate in the SFHGLP as approved lenders and that the escrowing process assists customers and ensures a greater homeownership success rate. Rural Development agrees that escrows



can promote homeownership success, but the same result can be achieved without escrows if other safeguards are in place. For example, a lender can still monitor tax assessments and payments absent an escrow account and, in cases of non-payment, take appropriate actions like contacting the borrower.

Others supported the proposal as providing greater opportunity for small rural lenders to participate in the SFHGLP.

Two respondents stated that lenders who lack capacity to escrow should be accountable for any deficiency in the servicing of these accounts.

Rural Development wishes to promote the interest of the SFHGLP to eligible rural lending institutions with the capability to underwrite and service loans, but without the capacity to escrow. Therefore, the final rule requires the lender to establish and maintain insured escrow accounts to pay real estate taxes and assessments and required hazard and flood insurance premiums when due, or, if the lender does not have the capacity to escrow, then the lender must implement internal monitoring processes to ensure that the borrower pays real estate taxes and assessments and required hazard and flood insurance premiums when due. In all cases, the lender is accountable for any deficiency in the servicing of these accounts. This rule will provide flexibility to small rural lenders while protecting the interests of the borrower and Rural Development. No significant change has been made to the language proposed.

Two respondents took exception to proposed § 3555.252 requiring the lenders to ensure all repairs or replacements using insurance loss claims be planned, performed, and inspected in accordance with Agency construction requirements. Both respondents suggested Rural Development adopt a dollar amount threshold (below) which the lender would not have to manage the repairs; rather, the insurance funds could be paid directly to the homeowner according to industry standards. The respondents suggested \$10,000 as the general industry standard. The Agency will adopt a “de minimis” threshold in § 3555.252 so that a specific amount may be defined in the handbook and adjusted according to changes in the industry standard. The current industry standard of \$10,000 will be adopted in the handbook, subject to change based on the industry standard. If the insurance claim is beneath the de minimis threshold and other requirements are met (i.e. the account is current and there is a history of timely payments; the borrower occupies the property; and the borrower executes an affidavit agreeing to apply the funds for repairs or reconstruction of the dwelling), the funds may be released directly to the borrower.”

One respondent asked Rural Development to include guidance regarding the requirements on reporting and delinquency notification. Rural Development concurs and has provided guidance consistent with mortgage industry standards. Lenders must notify a credit repository of each new guaranteed loan, identify the loan as guaranteed by the Agency, and must report to that repository whenever any account becomes more than 30 calendar days past due. No change is needed in the proposed language. Details on lender reports to the Agency are provided in the handbook.

#### Borrower actions requiring lender approval (§ 3555.255)

Rural Development's final rule on partial release of security property requires, in part, that the borrower receive adequate compensation and either make a reduction to the principal balance, or make improvements to the security property, in order to maintain the current loan-to-value ratio for the guaranteed loan. If the borrower receives adequate compensation for a partial release and makes a commensurate reduction to the principal balance or makes improvements to the security property, the pre-release loan-to-value for the guaranteed loan should be preserved or improved. This clarification has been added to the final rule which otherwise remains unchanged from the proposed.

#### Transfer and assumptions (§ 3555.256)

Some respondents suggested adding a section discussing the release of a co-obligor in cases of divorce. Rural Development's authorizing legislation, § 502(h)(10) of the Housing Act of 1949, as amended, prohibits this action, so this comment is not adopted.

One respondent expressed concern about transfers without triggering the due-on-sale clause arguing that fixed rate conventional documents do not allow assumability under original mortgage terms and that the Truth in Lending documents disclose that the loan is non-assumable. This section of the rule already discusses permissible transfers subject to Section 341 of the Garn St Germain Depository Institutions Act of 1982 (Pub. L. 97-320) and no change is made on this issue.

## Subpart G (§§ 3555.301 through 3555.308)

The Agency has reorganized and renumbered subpart G in order to better organize the information and present servicing options in the order in which lenders will generally consider them.

### General servicing techniques (§ 3555.301)

The final rule requires lenders to evaluate loss mitigation options in subpart G of the rule in an effort to resolve any repayment problems and provide borrowers with the maximum opportunity to become successful homeowners. The lender retains the discretion to choose which, if any, such options will best resolve the borrower's repayment problems while acting as a prudent lender and in the financial interests of the Government.

This section clarifies certain steps that are part of the industry standard practices the lender must take to contact a borrower who is in default, such as an initial contact to ascertain the circumstances of the default and possible resolution, and a certified letter requesting an interview with the borrower when the account becomes more than 60 days overdue. The Agency also clarifies that unless otherwise provided, Agency concurrence or a waiver is necessary for servicing plans that extend more than 90 days (§ 3555.301(h)). A waiver to the concurrence requirement may be issued if a lender demonstrates that it no longer needs oversight, which may be demonstrated by the lender's portfolio performance, such as lower than average delinquency rates, foreclosure

rates, or loss claim rates. Rural Development may revoke such waiver at any time, upon notice and without appeal rights.

In order to protect the interests of the Government, the Agency will require lenders to evaluate delinquent loans to determine whether any loss mitigation plan would be appropriate. However, the initial decision whether to offer a servicing plan to the borrower continues to be within the discretion of the lender, since the lender must determine whether the borrower is eligible for a servicing plan that can feasibly cure the delinquency before submitting any servicing plan for approval in accordance with § 3555.301(h).

#### Protective advances (§ 3555.302)

Two comments were received regarding protective advances. One respondent asked how the borrower would repay the advance. It is commonplace for security instruments and promissory notes to provide for protective advances to become part of the borrower's debt; hence, no change is made in response to this comment. One respondent recommended adoption of the section as proposed. Rural Development agrees with this respondent and believes the requirements related to protective advances are clear and no change is made to the regulation.

The rule further clarifies that protective advances for taxes and insurance do not require prior Agency concurrence. However, protective advances for costs other than taxes or insurance, such as emergency repairs, require Agency concurrence if the amount of the

advance is significant as determined by the Agency. The handbook currently sets the threshold for significant advances to be those exceeding \$2,000 and is based upon historical experience in responding to lenders who are caretaking abandoned properties in liquidation or are acquired in the lender's inventory.

#### Traditional servicing options (§ 3555.303)

The traditional servicing options – repayment agreement, special forbearance, reamortization and loan modification – previously covered in proposed §§ 3555.301, 3555.304 and 7 CFR 1980.373, have been consolidated into one section and renumbered as § 3555.303. The eligibility requirements for all traditional servicing is addressed in § 3555.303(a). Reamortization has been removed as a separate option since it is covered by loan modification.

One respondent requested clarification on extending the term of the loan. Under section 502(h)(7) of the Housing Act of 1949, as amended, the maximum loan term for SFHGLP loans is 30 years. However, section 502(h)(14)(H) permits loan modification when the borrower is in default or facing imminent default, and the term of the loan may be extended up to 40 years from the date of modification. Therefore, § 3555.303(b)(3) provides that traditional servicing loan modifications may include extending the term of the loan up to 30 years from the date of modification. The guarantee is effective 30 years from the origination date, and if the loan term is extended beyond the original 30 years (i.e. for another 30-year term), the guarantee will no longer apply beyond the original 30-year loan term. A clarification has been made to the rule. Extended-term loan

modifications, however, are available under § 3555.304 special servicing as discussed below in more detail.

One respondent requested clarification on allowable items for capitalization. The respondent suggested that foreclosure fees and costs, tax and insurance advances, and accrued interest be capitalized. The respondent further suggested that if the capitalization of these items results in a new loan amount that is higher than the principal loan amount originally guaranteed, the guarantee should then be based on the new and higher loan amount. Rural Development agrees that foreclosure fees and costs, tax and insurance advances, and past due principal and interest payments may be capitalized in a re-amortization designed as a loss mitigation technique. Such capitalization is consistent with mortgage industry practices and standards. Late charges or fees may not be capitalized. The amount of the guarantee, however, may not exceed the principal loan amount originally guaranteed, because the Loan Note Guarantee was issued at origination for a certain face value which cannot be amended by the lender. The regulation has been changed accordingly, and additional administrative guidance is provided in the handbook.

One respondent suggested these actions should require Agency concurrence prior to modification; failure to obtain Agency concurrence could increase loss claim exposure for Rural Development. Rural Development agrees, and the regulation has been changed accordingly in § 3555.301. Lenders will continue requesting concurrence from Rural Development to undertake modification and any other traditional servicing plans that

extend more than 90 days, unless a waiver is issued pursuant to § 3555.301(h) described above.

#### Special servicing options (§ 3555.304)

A new section has been added to provide Agency policy regarding special servicing options that lenders may utilize as authorized and implemented under the final rule published on August 26, 2010 (75 FR 52429-52435). Language regarding special servicing options was not published in the proposed streamlining rule. The Agency will allow lenders to extend loans for a term of up to 40 years from the date of modification under the special servicing options. The Agency will also allow lenders to advance funds on behalf of borrowers in amounts necessary to bring defaulted loans current, up to 30 percent of the unpaid principal balance of the loan. Upon request, the Agency will reimburse the lender for eligible advances. The intended effect of these special servicing options was to reduce mortgage foreclosures among SFHGLP borrowers and assist in stabilizing the national housing market. Before considering special servicing options, lenders must exhaust traditional servicing options or have determined that traditional servicing plans would not resolve the delinquency. The concurrence and waiver provisions of § 3555.301(h) apply to special servicing options.

Section 3555.10 is amended from the proposed rule to introduce in alphabetical order the definitions for “Extended-term loan modification,” “Maximum allowable interest rate,” “Mortgage payment to income ratio,” “Mortgage recovery advance,” and “Total debt to income ratio” as a result of this new section language.



### Voluntary Liquidation (§ 3555.305)

The liquidation section under the proposed rule (previously § 3555.305) has been divided into two sections – voluntary liquidation (§ 3555.305) and liquidation (§ 3555.306). The new § 3555.305 expands upon and clarifies the eligibility requirements for and methods of voluntary liquidation.

One respondent believed the wording in proposed § 3555.305 (c) regarding lump-sum payments in order to reinstate accelerated accounts would preclude the lender's ability to utilize loss mitigation alternatives. Rural Development removed this wording to more clearly reflect the lender's ability to utilize loss mitigation alternatives.

One respondent suggested that proposed § 3555.305(e) be changed to allow for alternative methods of voluntary liquidation when acceptable to Rural Development and documented by the lender. This suggestion is adopted in order to provide Rural Development and the lender with more flexibility and is included as § 3555.305(e).

One respondent noted that there are too many borrower situations and servicing alternatives under this section for all to be included in the regulations. Rural Development agrees, and the regulation has been changed so lenders will continue requesting concurrence from Rural Development, unless a waiver is provided in accordance with § 3555.301(h), to undertake the listed voluntary liquidation actions and other methods documented to result in savings to the Government.

#### Liquidation (§ 3555.306)

Several respondents expressed concern about Rural Development's proposal to eliminate the submission of property disposition plans to Rural Development for concurrence prior to marketing real estate owned (REO) property. Some suggested that failure to obtain Agency concurrence could increase loss claim exposure to Rural Development or result in exorbitant selling fees. Rural Development agrees, and the regulation has been changed accordingly. Lenders will continue submitting property disposition plans to Rural Development for concurrence. As discussed above, Rural Development may provide a written waiver of this requirement to the lender, on a case-by-case basis, if the lender demonstrates that it no longer needs the oversight. In such cases, the lender is still required to prepare and maintain a disposition plan on each acquired property, and this plan must be available for Agency review upon request for monitoring lender performance.

#### Assistance in natural disasters (§ 3555.307)

A new section has been added to explain agency policy during natural disasters. Servicers will use their general procedures to service affected borrower accounts, minimize delinquency, and avoid foreclosure. Servicers will inspect security property and service the account based on whether the property can be rebuilt, the status of the mortgage, amount of insurance proceeds, and the time needed to repair or reconstruct the property.

#### Loan guarantee limits (§ 3555.351)

One respondent requested a clear explanation and calculation breakdown on guaranteed loan limits stating that this information is critical in order to streamline and submit correct loss claim documentation. This section and the calculation of the loss payment section (§ 3555.352) have been rewritten for clarity and administrative guidance about loss claim submissions is provided in the handbook.

Subject to the loan guarantee limits, the loss claim payment is the difference between the total indebtedness on the loan and the net recovery value. The total indebtedness includes the unpaid principal balance, accrued interest from the last day of borrower payment to the settlement date, any interest on the unsatisfied principal balance which accrued within 90 days from the settlement date, principal and interest for protective advances, and reasonable and customary liquidation costs such as attorney fees and foreclosure costs.

#### Net recovery value (§ 3555.353)

One respondent expressed concern about Rural Development's current acquisition resale factor in calculating net recovery value. The respondent stated the factor is inadequate to cover all marketing expenses incurred and suggested Rural Development consider reasonable allowances to arrive at the actual net recovery value similar to HUD. The acquisition resale factor is only used when the lender still has ownership of the REO property at the time of filing a loss claim for payment. The disposition cost factor is reviewed by Rural Development and adjusted as warranted on an area basis, but not on a

case-by-case basis. Rural Development believes that the current factor is adequate to cover all marketing expenses incurred, and no change is made on this issue.

#### Loss claim procedures (§ 3555.354)

Several respondents commented on the requirements established regarding REO property. Several respondents commented that 90 days from the foreclosure date or the end of any applicable redemption period is insufficient to market and sell foreclosed property. Others requested guidance on filing claims. Rural Development agrees that, in many cases, 90 days will be insufficient. After further review and consideration of different economic and market conditions, the regulation has been amended so the lender must notify Rural Development if the property has not been sold within 9 months from the foreclosure date or applicable redemption period. The 9-month period should prove sufficient to market and sell foreclosed property under most economic and market conditions. Administrative procedures relative to the disposition of REO and filing claims are provided in the handbook.

One respondent requested the regulation provide evaluation criteria required to process a loss claim without a deficiency judgment. Section 3555.355 lists typical circumstances in which claims would be reduced or denied. Further processing guidance on this issue is provided in the handbook.

The period of time in which loss claims may be submitted after the property has been sold was increased in the final rule from 30 to 45 days in order to provide lenders more

flexibility in submitting the claims. Late claims submitted beyond this period of time may be rejected by Rural Development.

#### Future recovery (§ 3555.356)

Three respondents discussed the calculation and administration of future recovery. One suggested that Rural Development should reimburse the lender when the sale results in a loss and two respondents requested clarification on the administrative process of calculating the amount of future recovery. Rural Development believes that since the lender controls the sale process, reimbursing the lender for a loss could encourage the lender to accept less than a fair price at the sale. Reimbursing Rural Development for a share of future recovery is justified since Rural Development's claim payment was calculated based on a liquidation appraisal and not on an actual sale. Guidance regarding the future recovery process is provided in the handbook. No change is made in the final rule.

#### List of Subjects

##### 7 CFR Part 1980

Home improvement, Loan programs, Housing and community development, Mortgage insurance, Mortgages, Rural areas.

##### 7 CFR Part 3555

Administrative practice and procedure, Conflict of interests, Credit, Environmental impact statements, Equal credit opportunity, Fair housing, Flood insurance, Home improvement, Housing, Loan programs-Housing and community development, Low and moderate income housing, Manufactured homes, Mortgage insurance, Mortgages, Rural areas, Subsidies.

Therefore, Chapters XVIII and XXXV, Title 7, Code of Federal Regulations are amended as follows:

CHAPTER XVIII - RURAL HOUSING SERVICE, RURAL BUSINESS-  
COOPERATIVE SERVICE, RURAL UTILITIES SERVICE, AND FARM SERVICE  
AGENCY, DEPARTMENT OF AGRICULTURE

PART 1980 - GENERAL

1. The authority citation for part 1980 is revised to read as follows:

Authority: 5 U.S.C. 301; 7 U.S.C. 1989.

Subpart D – [Removed and Reserved]

2. Subpart D of part 1980 is removed and reserved.

CHAPTER XXXV - RURAL HOUSING SERVICE, DEPARTMENT OF  
AGRICULTURE

PART 3555 - GUARANTEED RURAL HOUSING PROGRAM

3. Part 3555, consisting of subparts A through H, is added to read as follows:

Subpart A - General

Sec.

- 3555.1           Applicability.
- 3555.2           Purpose.
- 3555.3           Civil rights.
- 3555.4           Mediation and appeals.
- 3555.5           Environmental requirements.
- 3555.6           State and local law.
- 3555.7           Exception authority.
- 3555.8           Conflict of interest.
- 3555.9           Enforcement.
- 3555.10          Definitions and abbreviations.
- 3555.11 - 3555.49   [Reserved]
- 3555.50          OMB control number.

Subpart B - Lender Participation

- 3555.51          Lender eligibility.
- 3555.52          Lender approval.
- 3555.53          Contracting for loan origination.
- 3555.54          Sale of loans to approved lenders.
- 3555.55 - 3555.99   [Reserved]
- 3555.100         OMB control number.

#### Subpart C - Loan Requirements

- 3555.101      Loan purposes.
- 3555.102      Loan restrictions.
- 3555.103      Maximum loan amount.
- 3555.104      Loan terms.
- 3555.105      Combination construction and permanent loans.
- 3555.106      [Reserved]
- 3555.107      Application for and issuance of the loan guarantee.
- 3555.108      Full faith and credit.
- 3555.109 - 3555.149 [Reserved]
- 3555.150      OMB control number.

#### Subpart D - Underwriting the Applicant.

- 3555.151      Eligibility requirements.
- 3555.152      Calculation of income and assets.
- 3555.153 - 3555.199 [Reserved]
- 3555.200      OMB control number.

#### Subpart E - Underwriting the Property

- 3555.201      Site requirements.
- 3555.202      Dwelling requirements.
- 3555.203      Ownership requirements.



- 3555.204 Security requirements.
- 3555.205 Special requirements for condominiums.
- 3555.206 Special requirements for community land trusts.
- 3555.207 Special requirements for Planned Unit Developments (PUDs).
- 3555.208 Special requirements for manufactured homes.
- 3555.209 Rural Energy Plus loans.
- 3555.210 - 3555.249 [Reserved]
- 3555.250 OMB control number.

#### Subpart F - Servicing Performing Loans

- 3555.251 Servicing responsibility.
- 3555.252 Required servicing actions.
- 3555.253 Late payment charges.
- 3555.254 Final payments.
- 3555.255 Borrower actions requiring lender approval.
- 3555.256 Transfer and assumptions.
- 3555.257 Unauthorized assistance.
- 3555.258 - 3555.299 [Reserved]
- 3555.300 OMB control number

#### Subpart G - Servicing Non-Performing Loans

- 3555.301 General servicing techniques.
- 3555.302 Protective advances.

- 3555.303 Traditional servicing options.
- 3555.304 Special servicing options.
- 3555.305 Voluntary liquidation.
- 3555.306 Liquidation.
- 3555.307 Assistance in natural disasters.
- 3555.308 - 3555.349 [Reserved]
- 3555.350 OMB control number.

#### Subpart H - Collecting on the Guarantee.

- 3555.351 Loan guarantee limits.
- 3555.352 Loss covered by the guarantee.
- 3555.353 Net recovery value.
- 3554.354 Loss claim procedures.
- 3555.355 Reducing or denying the claim.
- 3555.356 Future recovery.
- 3555.357 - 3555.399 [Reserved]
- 3555.400 OMB control number.

Authority: 5 U.S.C. 301; 42 U.S.C. 1471 et seq.

#### Subpart A - General

##### § 3555.1 Applicability.

This part sets forth policies for the Single Family Housing Guaranteed Loan Program (SFHGLP) administered by USDA Rural Development. It addresses the

requirements of section 502(h) of the Housing Act of 1949, as amended, and includes policies regarding originating, servicing, holding and liquidating SFHGLP loans. Any provision regarding the expenditure of funds under this part is contingent upon the availability of funds.

§ 3555.2 Purpose.

(a) General. The purpose of the SFHGLP is to provide low- and moderate-income persons who will live in rural areas with an opportunity to own decent, safe and sanitary dwellings and related facilities. The SFHGLP offers applicants without sufficient resources to provide the necessary housing on their own account, and unable to secure the credit necessary for such housing from other sources upon terms and conditions, which the applicant can reasonably be expected to fulfill without the guarantee, an opportunity to acquire, build, rehabilitate, improve, or relocate dwellings in rural areas.

(b) Demonstration programs. Rural Development may authorize limited demonstration programs as allowed by law. The objective of these demonstration programs will be to test new approaches to offering housing under the statutory authority granted to the Secretary. Therefore, such demonstration programs may not be consistent with all of the provisions contained in this part. However, any statutory SFHGLP requirements will remain in effect.

§ 3555.3 Civil rights.

Rural Development, lenders, and their agents must administer the program fairly, and in accordance with both the letter and the spirit of all equal opportunity, equal credit opportunity and fair housing legislation, and applicable executive orders. Loan guarantees, services, and benefits provided under this part shall not be denied to any person based on race, color, national origin, sex, religion, marital status, familial status, age (provided the applicant has the capacity to enter into a binding contract), handicap, receipt of income from public assistance, sexual orientation, or because the applicant has, in good faith, exercised any right under the Consumer Credit Protection Act (15 U.S.C. 1601 et seq.). All activities under this part shall be accomplished in accordance with the Fair Housing Act (42 U.S.C. 3601-3620), the Equal Credit Opportunity Act (15 U.S.C. 1691), and Executive Order 11063 as amended by Executive Order 12259, as applicable. Rural Development's civil rights compliance requirements are provided in 7 CFR part 1901, subpart E.

§ 3555.4 Mediation and appeals.

Whenever Rural Development makes a decision that will adversely affect a participant, the participant may proceed with alternative dispute resolution including mediation and a USDA National Appeals Division hearing in accordance with 7 CFR parts 1 and 11. The participant also may request an informal review of the adverse decision made by Rural Development. Except when the adverse decision applies to a loss claim, the applicant or borrower and the lender may participate in the appeal process. Adverse decisions made by the lender cannot be appealed unless concurrence by Rural Development was required by this subpart and obtained by the lender.

§ 3555.5 Environmental requirements.

(a) Policy. Rural Development will consider environmental quality, economic, social, and other relevant factors in program development and decision-making processes. Rural Development will take into account potential environmental impacts of proposed projects by working with applicants, other Federal agencies, American Indian tribes, State and local governments, and interested citizens and organizations in order to formulate actions that advance the program's goals in a manner that will protect environmental quality.

(b) Regulatory references. Loan processing and servicing actions under this part will be completed in accordance with the requirements of part 1940, subpart G of this title and part 1924, subpart A of this title, which addresses lead-based paint requirements; and any other Agency regulations addressing environmental requirements for the SFHGLP.

(c) Agency responsibilities. Rural Development is responsible for compliance with all applicable environmental regulations and statutes.

(d) Lender and loan applicant responsibilities. (1) Lenders must use due diligence in regard to potential environmental hazards to ensure the property is decent, safe and sanitary and of sufficient value to adequately secure the loan. The level of due diligence review to determine potential environmental hazards must be equivalent to the standards established by Fannie Mae, Freddie Mac, FHA, or the VA.

(2) Mortgage loan transactions will be subject to the requirements of the 1994 National Flood Insurance Reform Act to determine if the dwelling is located in a Special Flood Hazard Area (SFHA).

(3) On an as needed basis, lenders and loan applicants will assist Rural Development in obtaining such information as Rural Development needs to complete its environmental review and to cooperate in the resolution of environmental problems.

(4) Lenders will become familiar with Agency environmental requirements, so they can advise applicants and reduce the probability of unacceptable applications being submitted to Rural Development.

(5) The lender must comply with Federally mandated flood insurance purchase requirements. Existing dwellings in a SFHA are not eligible under the SFHGLP unless flood insurance through the FEMA National Flood Insurance Program (NFIP) is available. The lender will require the borrower to obtain, and maintain for the term of the mortgage, flood insurance for any property located in a SFHA, listing the lender as a loss payee.

(6) The borrower must obtain, and continuously maintain for the life of the mortgage, flood insurance on the security property in an amount sufficient to protect the property securing the guaranteed loan. Flood insurance policies must be issued under the NFIP, or by a licensed property and casualty insurance company authorized to participate in NFIP's "Write Your Own" program.

(7) Rural Development, will not guarantee loans for new or proposed homes in an SFHA unless the lender obtains a Letter of Map Amendment (LOMA) that removes the property from the SFHA or Letter of Map Revision (LOMR) that removes the property

from the SFHA or obtains a FEMA elevation certificate that shows that the lowest habitable floor (including basement) of the dwelling and all related building improvements is built at or above the 100 year flood plain elevation in compliance with the NFIP.

§ 3555.6 State and local law.

Lenders will comply with applicable State and local laws and regulations, including the laws of American Indian tribes. Supplemental guidance will be issued in the case of any conflict with or significant differences from provisions of this part.

§ 3555.7 Exception authority.

The Administrator of the Agency, or a designee, may make an exception to any requirement or provision of this part or to address any omissions in this part, when the Administrator, or designee, determines that application of the requirement or failure to take action would adversely affect the Government's interest. Any exception must be consistent with the authorizing statute and other applicable laws.

§ 3555.8 Conflict of interest.

(a) Applicant or borrower responsibility. The applicant or borrower must disclose to the lender any prohibited relationship or association with any Rural Development employee, and the lender must disclose that information to Rural Development.

(b) Lender responsibility. The lender must disclose to Rural Development any prohibited relationship or association it, or any of its employees, has with any Rural Development employee.

(c) Prohibited relationships and associations. Prohibited relationships and associations include the following:

(1) Immediate family members, including parents and children, whether related by blood or marriage;

(2) Close relatives, including grandmother, grandfather, aunt, uncle, sister, brother, niece, nephew, granddaughter, grandson, or first cousin, whether related by blood or marriage;

(3) Any household residents;

(4) Immediate working relationships, including coworkers in the same office, subordinates, and immediate supervisors; and

(5) Close business associations, including business partnerships, joint ventures, or closely held corporations.

(d) Result of disclosure. Disclosure of prohibited relationships and associations under this section will not necessarily result in applicant, borrower or lender ineligibility. Disclosures may result in reassignment with regard to the loan guarantee in question so that no prohibited relationships or associations exist between the Rural Development employees responsible for loan guarantee transactions and lenders, borrowers, or applicants.



Rural Development will take such actions as are appropriate and necessary to enforce the provisions of these regulations. Such actions will include, but not be limited to, reduction of the loss claim payment; termination of a lender's or servicer's participation in the SFHGLP; suspension and debarment of participation in this or other Federal programs; and, any other appropriate administrative, civil, or criminal actions as allowed by law. Rural Development may assess civil monetary penalties pursuant to Section 543 of the Housing Act of 1949, 42 U.S.C. 1409s(b).

§ 3555.10 Definitions and abbreviations.

The definitions and abbreviations in this section apply to this part.

Acceleration. Demand for immediate repayment of the entire balance of a debt if the covenants in the promissory note, assumption agreement, or security instruments are breached.

Adjusted annual income. Income from all household members who live or propose to live in the dwelling as their primary residence for all or part of the ensuing 12 months. Adjusted annual income is used to determine whether an applicant is income-eligible for a guaranteed loan, or interest assistance, if applicable. Adjusted annual income provides for deductions to account for varying household circumstances and expenses. See § 3555.152(c) for a complete description of adjusted annual income.

Agency. The Rural Housing Service of the U.S. Department of Agriculture, Rural Development.

Agency employee. Any employee of the Rural Housing Service, or any employee of the Rural Development mission area who carries out SFHGLP functions.

Alien. See “Qualified alien.”

Amortization. A gradual reduction of the mortgage debt through equal monthly principal and interest payments sufficient to fully repay the unpaid principal balance over the mortgage term.

Amortized payment. Equal monthly payments under a fully amortized mortgage loan that provides for the scheduled payment of interest and principal over the term of the loan.

Annual fee. A periodic amount that is based on the average annual scheduled unpaid principal balance of the loan and is paid by the servicing lender to Rural Development on an annual basis for issuance of a Loan Note Guarantee. The fee may be passed on to the borrower and included in the monthly mortgage payment of a borrower and is used when calculating payment ratios.

Annual income. The income of all household members calculated according to § 3555.152(b). Annual income is used to determine adjusted annual income in § 3555.152(c) for program eligibility purposes.

Applicant. An individual applying to a lender for a guaranteed loan.

Area median income. The median income in a specific locality, typically a county or Metropolitan Statistical Area (MSA), as determined by the Department of Housing and Urban Development.

Assumption. A method of selling real estate wherein the property purchaser accepts the liability for payment of an existing mortgage.

Borrower. An individual obligated to repay the loan guaranteed under the Guaranteed Rural Housing loan program.

Combination construction and permanent loan. A guaranteed loan on which the Rural Development guarantee becomes effective at the time construction of an eligible single family housing project begins.

Community land trust. A private nonprofit community housing development organization that is established to acquire parcels of land, held in perpetuity, primarily for conveyance under long-term ground leases. See section 502(a)(3)(B) of the Housing Act of 1949, 42 U.S.C. 1472(a)(3)(B), as amended.

Conditional commitment. Rural Development's agreement that a proposed loan will be guaranteed if all conditions and requirements established by Rural Development are met.

Condominium project. A real estate project in which each owner has title to a unit in a building, an undivided interest in the common areas of the project and sometimes the exclusive use of certain limited common areas. See § 526(d) of the Housing Act of 1949, as amended.

Debarment. An action taken under 2 CFR part 180 or 417 to exclude a person or entity from participating in Federal programs.

Disability. See "Person with a disability."

Dwelling. A house, manufactured home, or condominium unit, and related facilities, such as a garage or storage shed, used or to be used as the borrower's principal residence.

Elderly family. An elderly family consists of one of the following:

(1) A person who is the head, spouse, or sole member of a household and who is 62 years of age or older, or who is disabled, and is an applicant or borrower;

(2) Two or more persons who are living together, at least one of whom is age 62 or older, or disabled, and who is an applicant or borrower; or

(3) Where the deceased borrower or spouse in a household was at least 62 years old or disabled, the surviving household member shall continue to be classified as an elderly household for the purpose of determining adjusted income, even though the surviving members may not meet the definition of an elderly family on their own, provided:

(i) They occupied the dwelling with the deceased household member at the time of the death;

(ii) If one of the surviving household members is the spouse of the deceased household member, the surviving household shall be classified as an elderly family only until the remarriage or death of the surviving spouse; and

(iii) At the time of the death of the deceased household member the dwelling was financed with a Guaranteed Rural Housing loan.

Escrow account. A trust account that is established by the lender or its servicing agent to hold funds collected from the borrower and allocated for the payment of real estate taxes, special assessments, hazard or flood insurance premiums, and other similar expenses.

Existing dwelling. A dwelling that does not meet the definition of “new dwelling”.

Extended-term loan modification. A loan modification authorized under § 3555.304 of this part, in which the lender reduces the interest rate to a level at or below the maximum allowable interest rate and then extends the repayment term up to a maximum of 40 years

from the date of loan modification, but only as long as is necessary to achieve the targeted mortgage payment to income ratio.

Fannie Mae. A private, shareholder-owned company with a charter from Congress to support the housing finance system, formerly officially known as the Federal National Mortgage Association.

FEMA. The United States Department of Homeland Security, Federal Emergency Management Agency.

FHA. The Federal Housing Administration of the United States Department of Housing and Urban Development.

FHLB. Federal Home Loan Bank.

First-time homebuyer. Individuals who meet any one of the following three criteria are considered first-time homebuyers:

(1) An individual who has had no ownership interest in a principal residence during the three-year period ending on the date of loan closing.

(2) An individual who is a displaced homemaker and who, except for owning a home with a spouse, has had no ownership interest in a principal residence during the three-year period ending on the date of loan closing. Displaced homemakers include any individual who is:

(i) An adult;

(ii) Unemployed or underemployed;

(iii) Experiencing difficulty in obtaining or upgrading employment; and

(iv) In recent years has worked primarily without remuneration to care for the home and family, but has not worked full-time, full-year in the labor force.

(3) An individual who is a single parent and who, except for owning a home with a spouse, has had no ownership interest in a principal residence during the three-year period ending on the date of loan closing. Single parents include any individual who is:

(i) Unmarried or legally separated; and

(ii) Has custody or joint custody of one or more children, or is pregnant.

Forbearance agreement. An agreement between the lender and the borrower providing for temporary suspension of payments or a repayment plan that calls for periodic payments of less than the normal monthly payment, periodic payments at different intervals, etc. to bring the account current.

Freddie Mac. A private, shareholder owned company with a charter from Congress to support the housing finance system, formerly officially known as the Federal Home Loan Mortgage Corporation.

Funded buydown account. An escrow account funded by the lender, seller, or through a third party gift, from which monthly payments are released directly to the lender to reduce the amount of interest on a loan, thereby improving an applicant's repayment ability.

Ginnie Mae. Government National Mortgage Association, a Government-owned corporation within HUD.

Household. All persons routinely living in the dwelling as principal residence, except for live-in aides, foster children, and foster adults.

Housing Act of 1949. The Act which, in part, provides the authority for single family housing programs, codified at 42 U.S.C. 1471 et seq.

HUD. The United States Department of Housing and Urban Development.

Interest assistance. Agency assistance available to eligible borrowers that reduces the effective interest rate on the guaranteed loan. Interest assistance applied to borrowers whose loans were approved as a subsidized guaranteed loan between April 17, 1991, and September 30, 1991, and who entered into interest assistance and shared equity agreements at loan closing.

IRS. The Internal Revenue Service of the United States Department of the Treasury.

Leasehold estate. The right to use and occupy real estate for a stated term and under conditions which have been conveyed by a lease.

Lender. The entity making, holding, or servicing a loan that is guaranteed under the provisions of this part.

Live-in aide. A person who:

- (1) Lives with an elderly person or a person with a disability and
- (2) Is essential to that person's care and well-being, and
- (3) Is not obligated for the person's support, and
- (4) Would not be living in the unit except to provide the support services.

Loan modification. A written agreement that permanently changes an original note term, such as the interest rate, monthly payment, and/or the principal balance due to capitalization of interest or advances.

Low-income. An adjusted income that is greater than the HUD established very low-income limit, but that does not exceed the HUD established low-income limit (generally 80 percent of median income adjusted for household size) for the county or Metropolitan Statistical Area where the property is or will be located.

Manufactured home. A structure that is built on a permanent foundation according to Federally Manufactured Home Construction and Safety Standards established by HUD and found at 24 CFR part 3280.

Market value. The value of the property as determined by a current appraisal made in accordance with the Uniform Standards of Professional Appraisal Practices.

Maximum allowable interest rate. For purposes of § 3555.304, the rate established by the Agency in a Federal Register notice describing how to calculate the maximum allowable interest rate. If the maximum allowable interest rate has not been established by notice in the Federal Register, the maximum allowable interest rate shall be 50 basis points greater than the most recent Freddie Mac Weekly Primary Mortgage Market Survey (PMMS) rate for 30-year fixed-rate mortgages (U.S. average), rounded to the nearest one-eighth of one percent (0.125%), as of the date the loan modification is executed. Weekly PMMS rates are published on the Freddie Mac website, and the Federal Reserve Board includes the average 30-year PMMS rate in the list of Selected Interest Rates that it publishes weekly in its Statistical Release H.15.

Median income. The area median income, adjusted for family size, as established by HUD.

Moderate income. The greater of:

- (1) 115 percent of the U.S. median family income,
- (2) The average of the state-wide and state non-metro median family income,
- (3) 115/80ths of the area low-income limit adjusted for household size for the county or MSA where the property is, or will be, located.



Modest housing. For purposes of this part, “modest housing” is the housing that a low- or moderate-income borrower can afford based on their repayment ability.

Mortgage. A form of security instrument or consensual lien on real property including a real estate mortgage and a deed of trust.

Mortgage credit certificate. A certificate issued by an authorized State or local housing finance agency that documents a Federal income tax credit awarded to a first-time homebuyer and/or low- or moderate-income homebuyer. The Federal income tax credit reduces the applicant’s Federal income tax liability, which improves his or her repayment ability.

Mortgage payment to income ratio. As used in § 3555.304, this ratio is the monthly mortgage payment (principal, interest, taxes, and insurance) divided by the borrower’s gross monthly income.

Mortgage recovery advance. A mortgage recovery advance is funds advanced by the lender on behalf of a borrower to satisfy the borrower’s arrearage, pay legal fees and foreclosure costs related to a cancelled foreclosure action, and reduce principal. Upon request, RHS will reimburse the lender for eligible mortgage recovery advances under § 3555.304.

MSA (Metropolitan Statistical Area). A geographic entity defined by the United States Office of Management and Budget.

Net family assets. The value of assets available to a household, as contained in § 3555.152(d).

Net recovery value. The amount available to apply to the outstanding unpaid loan balance after considering the value of the security property and other amounts recovered, and deducting the costs associated with liquidation, acquisition and sale of the property. Net recovery value is calculated differently depending on the type of disposition, as contained in § 3555.353.

New dwelling. A dwelling that is to be built is under construction, or a dwelling that is less than one year old and has never been occupied. A manufactured home is considered a new unit if the manufacturer's date is within 12 months of the purchase contract and the unit has never been occupied or installed at any other location as otherwise provided by Rural Development.

Participant. For the purpose of appeals, a participant is any individual or entity that has applied for, or whose right to participate in or receive a payment, loan guarantee, or other benefit, is affected by an Agency decision in accordance with 7 CFR 11.1.

Person with a disability. Any person who has a physical or mental impairment that substantially limits one or more major life activities, including functions such as caring for one's self, performing manual tasks, walking, seeing, hearing, speaking, breathing, learning and working, has a record of such an impairment, or is regarded as having such an impairment.

Planned Unit Development. For the purpose of this definition, a condominium is not a Planned Unit Development (PUD). A PUD is a development that has all of the following characteristics:

- (1) The individual unit owners own a parcel of land improved with a dwelling.

This ownership is not in common with other unit owners;

(2) The development is administered by a homeowners association that owns and is obligated to maintain property and improvements within the development (for example, greenbelts, recreation facilities and parking areas) for the common use and benefit of the unit owners; and

(3) The unit owners have an automatic, non-severable interest in the homeowners association and pay mandatory assessments.

Pre-foreclosure sale. A sale of property in which the lender and borrower agree to accept the proceeds of the sale to satisfy a defaulted mortgage, even though this may be less than the amount owed on the mortgage, in order to avoid foreclosing on the property.

Primary residence. See “Principal residence.”

Principal residence. The home domicile physically occupied by the owner for the major portion of the year and the address of record for such activities as Federal income tax reporting, voter registration, occupational licensing, etc.

Prior lien. A lien against the security property that is superior in right to the lender’s debt instrument.

Qualified alien. See the definition of the term under Section 401 of the Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (PRWORA) (8 U.S.C. 1641).

Real estate taxes. Taxes and assessments estimated to be due and payable on the property.

REO (Real Estate Owned). Property that formerly served as security for a guaranteed loan and for which the lender holds title.

Repayment income. Used to determine whether an applicant has the ability to make monthly loan payments. Repayment income may include amounts excluded for the purpose of determining adjusted annual income. See § 3555.152(a) for a complete description of repayment income.

Rural area. The definition of “rural area” is found in section 520 of the Housing Act of 1949, as amended.

Rural Development. A mission area within USDA that includes the Rural Housing Service, the Rural Utilities Service, and the Rural Business-Cooperative Service.

Scheduled payment. The monthly installment on a promissory note, as modified by an interest assistance agreement or forbearance agreement, plus escrow payments.

Secured loan. A loan that is collateralized by property so that in the event of a default on the loan, the property may be sold to pay down the debt.

Security instrument. The mortgage, or deed of trust, that secures the promissory note or assumption agreement.

Security property. All the real property that serves as collateral for a guaranteed loan.

Settlement date. The settlement date, for the purpose of loss calculation, is the later of the following:

- (1) Actual foreclosure date;
- (2) The closing date, if sold to a third party at the foreclosure sale;
- (3) The date the borrower sells the property to a third party in order to avoid or cure a default situation, with prior approval of the lender; and
- (4) When title is acquired to the security following the expiration of any state-required redemption or confirmation period.

SFHGLP. Single Family Housing Guaranteed Loan Program. The SFHGLP guarantees loans under section 502 of the Housing Act of 1949. Under the guarantee, the holder of the loan note may be reimbursed by Rural Development for all or part of a loss incurred if a borrower defaults on a loan.

Short sale. A type of voluntary liquidation (also referred to as a preforeclosure sale or short payoff) where a borrower and the lender who holds the mortgage on the property agree to sell the property at fair market value, but for less than the current outstanding debt (including any missing payments, late fees, penalties, and advances for taxes and the like).

Supplemental loan. A guaranteed loan made in conjunction with a transfer and assumption to provide funds to complete the transaction.

Suspension. An action taken under 2 CFR parts 180 or 417 to exclude a person or entity from participation in Federal programs for a temporary period, pending completion of an investigation of wrongdoing.

Total debt to income ratio. Total debt to income ratio is defined as the borrower's monthly mortgage payment plus all recurring monthly debt divided by the borrower's gross monthly income.

Unauthorized assistance. Any guaranteed loan or interest assistance for which there was no regulatory or statutory authorization, or for which the borrower was not eligible.

United States citizen. An individual who resides as a citizen in any of the 50 States, the District of Columbia, the Commonwealth of Puerto Rico, the U.S. Virgin Islands, Guam, American Samoa, the Commonwealth of the Northern Marianas, the Federated States of Micronesia, the Republic of Palau, or the Republic of the Marshall Islands.

USDA. The United States Department of Agriculture.

U.S. non-citizen national. A person born in American Samoa or Swains Island on or after the date the U.S. acquired American Samoa or Swains Island, or a person whose parents are U.S. non-citizen nationals.

VA. United States Department of Veterans Affairs.

Veterans' preference. A preference in loan processing extended to a SFHGLP loan applicant who served on active duty and has been discharged or released from the active forces on conditions other than dishonorable from the United States Army, Navy, Air Force, Marine Corps, or Coast Guard. The preference applies to the service person, or the family of a deceased serviceperson who died in service before the termination of such war or such period or era. The applicable timeframes are:

- (1) During the period of April 6, 1917, through March 31, 1921;
- (2) During the period of December 7, 1941, through December 31, 1946;
- (3) During the period of June 27, 1950, through January 31, 1955;
- (4) For a period of more than 180 days, any part of which occurred after January 31, 1955, but on or before May 7, 1975;
- (5) During the period beginning August 2, 1990, and ending January 2, 1992, provided, of course, that the veteran is otherwise eligible; or
- (6) During any other period as prescribed by Presidential proclamation or law.

§§ 3555.11 - 3555.49 [Reserved]

§ 3555.50      OMB control number.

The report and recordkeeping requirements contained in this subpart have been approved by the Office of Management and Budget and have been assigned OMB control number 0575-0179.

#### Subpart B - Lender Participation

##### § 3555.51 Lender eligibility.

A lender must meet the requirements described in this section to be approved for participation in the SFHGLP.

(a) Ability to underwrite and service loans. The lender must have a demonstrated ability to underwrite and service single-family home loans. A lender will be considered to have such a demonstrated ability if it qualifies as one of the following:

- (1) A State Housing Agency;
- (2) A lender approved as a supervised or non-supervised mortgagee by HUD with direct endorsement authority for submission of applications for Federal Housing Mortgage Insurance;
- (3) A supervised or non-supervised mortgagee with authority to close VA-guaranteed loans on the automatic basis;
- (4) A lender approved by Fannie Mae for single-family loans;
- (5) A lender approved by Freddie Mac for single-family loans;
- (6) A Farm Credit System institution that provides documentation of its ability to underwrite and service single-family loans. Lenders who are a Farm Credit System lender with direct lending authority meet demonstrated ability;

(7) A lender participating in other Rural Development or Farm Service Agency guaranteed loan programs that provide documentation of its ability to underwrite and service single family loans. Documentation criteria for other Rural Development or Farm Service Agency guarantee loan programs require an active lender agreement; or

(8) A Federally supervised lender that provides documentation of its ability to originate, underwrite and service single-family loans. Acceptable sources of supervision include:

- (i) Being a member of the Federal Reserve System;
- (ii) The Federal Deposit Insurance Corporation (FDIC);
- (iii) The National Credit Union Administration (NCUA);
- (iv) The Office of Thrift Supervision (OTS);
- (v) The Office of the Comptroller of the Currency (OCC).

(vi) The Federal Housing Finance Board regulating lenders within the Home Loan Bank FHLB system.

(9) A lender may demonstrate its ability to originate and underwrite loans by submitting appropriate documentation, examples of which include, but are not limited to:

- (i) A summary of residential mortgage lending activity.
- (ii) Written criteria outlining the lender's policy and procedures for originating, underwriting and closing residential mortgage loans.
- (iii) Evidence of an experienced loan underwriter on staff.
- (iv) Certification the lender will contract with an Agency-approved lender meeting the criteria to participate in the program as a servicer.



(10) A lender may demonstrate its ability to service loans by submitting appropriate documentation, examples of which include, but are not limited to:

(i) Evidence of a written plan when contracting for escrow services.

(ii) Evidence the lender has serviced single-family residential mortgage loans in the year prior to request lender approval to participate in the SFHGLP.

(b) SFHGLP participation requirements. Lenders and their agents must comply with the following requirements:

(1) Keep up to date, and comply with, all Agency regulations and handbooks, including all amendments and revisions of program requirements and policies. Lenders who originate a minimal number loans, as determined by the Agency, in a 24 month time frame may be required to take updated training to ensure a lender's continued knowledge of the program;

(2) Regularly check Rural Development's Web site for new issuances related to the program;

(3) Underwrite loans according to Rural Development regulations and process and approve loans in accordance with program instructions;

(4) Review loan applications for accuracy and completeness,

(5) Ensure that applicant income limits are not exceeded;

(6) Ensure that borrowers have adequate loan repayment ability and acceptable credit histories;

(7) Ensure that loss claims include only supportable costs;

(8) Cooperate fully with Agency reporting and monitoring requirements;

(9) Comply with limitations on loan purposes, loan limitations, interest rates, and loan terms;

(10) Inform Rural Development immediately after the sale, transfer, or change of servicers of any Agency guaranteed loan;

(11) Maintain reasonable and prudent business practices consistent with generally accepted mortgage industry standards, such as maintaining fidelity bonding;

(12) Remain responsible for servicing even if servicing has been contracted to a third party;

(13) Use Rural Development, HUD, Fannie Mae, or Freddie Mac forms, unless otherwise approved by Rural Development;

(14) Maintain eligibility under paragraph (a) of this section;

(15) Notify Rural Development if there are any material changes in organization or practices;

(16) Be neither debarred nor suspended from participation in Federal programs, not debarred, suspended or sanctioned under state licensing and certification laws and regulation;

(17) Notify Rural Development in the event of its bankruptcy or insolvency;

(18) Remain free from default and delinquency on any debt owed to the Federal government;

(19) Allow Rural Development or its representative access to the lender's records, including, but not limited to, records necessary for on-site and desk reviews of the lender's operation and the operations of any of its agents to verify compliance with Agency regulations and guidelines;

(20) Maintain adequate operational quality control and reporting procedures to prevent mortgage fraud;

(21) Maintain complete loan files with all required documentation that is accessible by the Agency upon request for review; and

(22) Execute a lender's agreement provided by Rural Development.

§ 3555.52 Lender approval.

(a) Initial approval. The lender must apply for and receive approval from Rural Development to participate in the SFHGLP. Application forms are available from Rural Development.

(b) Conditions of approval. The lender must provide evidence to support their ability to originate, underwrite and/or service SFHGLP loans as outlined in § 3555.51(a), including evidence of the lender's internal loan criteria and quality control. New lenders will be subject to mandatory training prior to lender approval in accordance with Agency procedures.

(c) Termination of approval. Lender approval may be terminated in any of the following situations:

(1) Lapse of any eligibility requirement. In the event that a lender fails to meet any of the requirements described in § 3555.51, the lender must notify Rural Development immediately. Rural Development may terminate the lender's approval upon written notice and in accordance with the lender's agreement. The Agency may take other appropriate corrective action due to non-compliance with any of the

requirements in this part and the lender's agreement. A lender whose approval has been terminated must sell any SFHGLP loans it holds to an approved lender immediately, and in no event later than 6 months, after termination of approval.

(2) Voluntary withdrawal. The lender may choose to end participation in the SFHGLP at any time. If the withdrawing lender has originated SFHGLP loans and obtained conditional commitments but has not closed the loans, or is holding or servicing SFHGLP loans, the lender must make arrangements prior to withdrawing for the transfer of such loans to lenders approved to participate in the SFHGLP.

§ 3555.53 Contracting for loan origination.

Lenders may contract with mortgage brokers, non-approved lenders, or other entities for loan origination services, closing services, or both, provided the loan is transferred immediately after closing to an Agency approved lender to which the guarantee will be issued. The approved lender is responsible for ensuring that the loan is properly underwritten, obtaining the conditional commitment, ensuring that the loan is properly closed, and ensuring that all closing costs, financing, and settlement fees meet Agency program requirements.

§ 3555.54 Sale of loans to approved lenders.

Lenders may sell SFHGLP loans only to other Agency-approved lenders, Fannie Mae, Freddie Mac, or the Federal Home Loan Banks. In such a sale, the purchasing lender acquires all rights of the selling lender under the Loan Note Guarantee, and

assumes all of the selling lender's obligations contained in any note, security instrument, or Loan Note Guarantee in connection with the loan purchased. The purchasing lender may be subject to any defenses, claims, or offsets that Rural Development would have had against the selling lender if the selling lender had continued to hold the loan. The lender must notify Rural Development immediately upon the sale or transfer of servicing of a SFHGLP loan.

§§ 3555.55 - 3555.99 [Reserved]

§ 3555.100 OMB control number.

The report and recordkeeping requirements contained in this subpart have been approved by the Office of Management and Budget and have been assigned OMB control number 0575-0179.

#### Subpart C - Loan Requirements

§ 3555.101 Loan purposes.

Loan funds must be used to acquire a new or existing dwelling to be used by the applicant as a principal residence.

(a) Eligible purposes. Loan funds may be used for:

- (1) The construction or purchase of a new dwelling;
- (2) The cost of acquisition of an existing dwelling;
- (3) The cost of repairs associated with the acquisition of an existing dwelling; or

(4) Acquisition and relocation of an existing dwelling.

(b) Eligible costs. Loan funds also may be used to pay for the following items associated with the acquisition of a dwelling:

(1) Purchase and installation of essential household equipment in the dwelling such as wall-to-wall carpeting, ovens, ranges, refrigerators, washing machines, clothes dryers, heating and cooling equipment, and other similar items as long as the equipment is conveyed with the dwelling and such items are typically included in the purchase of similar dwellings in the area.

(2) Purchase and installation of energy-saving measures.

(3) Site preparation including grading, foundation, plantings, seeding or sodding, trees, walks, fences, and driveways to the home.

(4) A supplemental loan to provide funds for seller equity or essential repairs when an existing guaranteed loan is assumed simultaneously.

(5) Special design features or equipment when necessary because of a physical disability of the applicant or a member of the household.

(6) Loan funds may be used to pay for reasonable and customary expenses related to obtaining the loan. Allowable loan expenses include:

(i) Legal, architectural, and engineering fees;

(ii) Title exam, title clearance and title insurance;

(iii) Transfer taxes and recordation fees;

(iv) Appraisal, property inspection, surveying, environmental, tax monitoring, and technical services;

(v) Homeownership education.

(vi) For low-income borrowers only, reasonable and customary loan discount points to reduce the note interest rate from the rate authorized in § 3555.104(a).

(vii) Reasonable and customary non-recurring closing costs associated with the mortgage transaction that do not exceed those charged other applicants by the lender for similar transactions such as FHA-insured or VA-guaranteed first mortgage loans. If the lender does not participate in such programs, the loan closing costs may not exceed those charged other applicants by the lender for a similar loan program that requires conventional mortgage insurance or guarantee. Allowable closing costs include the actual cost of credit reports, the loan origination fee, settlement fee, deposit verification fees, document preparation fees (if performed by a third party not controlled by the lender), and other reasonable and customary costs as determined by Rural Development. Payment of finder's fees or placement fees for the referral of an applicant to the lender is prohibited.

(viii) Reasonable connection fees, assessments, or the pro rata installment costs for utilities such as water, sewer, electricity and gas for which the borrower is responsible.

(ix) The prorated portion of real estate taxes that is due and payable on the property at the time of closing and to establish escrow accounts for real estate taxes, hazard and flood insurance premiums, and related costs.

(x) The amount of the loan up-front guarantee fee required by § 3555.107(h).

(xi) The cost of establishing a cushion in the mortgage escrow account for payment of the annual fee required by § 3555.108(g), not to exceed 2 months.

(xii) If the seller or other third party pays any of the costs described in this section, the amount of the costs paid by the seller or other third party may not be included in the loan amount to be guaranteed.

(c) Combination construction and permanent loan. Loan funds may be used and Rural Development will guarantee a “combination construction and permanent loan” as defined at § 3555.10, during the term of construction and prior to the borrower occupying the property, subject to the conditions in § 3555.105.

(d) Refinancing. Refinancing is permitted only in the following situations:

(1) The loan may be used for permanent financing when temporary financing to construct a new dwelling, or to purchase and improve an existing dwelling, is arranged as a part of the loan package.

(2) In the case of loans for a site on which a dwelling is not constructed prior to issuance of the Loan Note Guarantee, refinancing is permitted if:

(i) The site is free and clear of debt;

(ii) The debt to be refinanced was incurred for the sole purpose of purchasing the site;

(iii) The applicant is unable to acquire adequate housing without refinancing; and

(iv) An appropriate dwelling will be constructed on the site.

(3) The loan is a present Section 502 Direct or guaranteed loan, authorized under the Housing Act of 1949 subject to the following additional requirements:

(i) The interest rate of the new loan must be fixed. The rate of the new loan must be at least 100 basis points below the original rate of the loan refinanced.



(ii) The loan security must include the same property as the original loan and be owned and occupied by the borrowers as their principal residence.

(iii) Existing borrowers seeking to refinance must have demonstrated their ability to meet payment demands by maintaining a current account for the 180 days prior to application.

(iv) Borrowers may be added to or deleted from a refinance transaction. At least one of the borrowers (primary or co-borrower(s)) must remain to qualify as a refinance transaction. All applicants who will be a party to the note must meet eligibility requirements.

(v) The maximum loan amount cannot exceed the balance of the loan being refinanced including accrued interest, the guarantee fee, and reasonable and customary closing costs. When a direct loan is refinanced, any recapture amount owed may be included in the loan amount or deferred as long as the recapture amount takes a subordinate lien position to the new SFHGLP loan. A discount on the recapture amount may be offered if the borrower does not defer recapture or includes the recapture amount in the new loan.

(vi) Two options for refinancing can be offered. Lenders may offer a streamlined refinance for existing Section 502 Guaranteed loans, which does not require a new appraisal. Streamlined financing may not be available for existing Section 502 Direct loans. The lender will pay off the balance of the existing Section 502 Guaranteed loan. The new loan amount cannot include any closing costs or lender fees. The refinance up-front guarantee fee as established by the Agency can be included in the loan to be refinanced to the extent financing does not exceed the original loan amount. Lenders

may offer non-streamlined refinancing for existing Section 502 Guaranteed or Direct loans, which requires a new and current market value appraisal. The new loan may include the principal and interest of the existing Agency loan, reasonable closing costs and lenders fees to extent there is sufficient equity in the property as determined by an appraisal. The appraised value may be exceeded by the amount of up-front guarantee fee financed, if any, when using the non-streamlined option. Documentation, costs, and underwriting requirements of subparts D, E, and F of this part apply to refinances.

(vii) Lenders may require property inspections and/or repairs as a condition to loan approval. Expenses related to property inspections and repairs required of the lender may not be financed into the new loan amount.

(viii) The lender pays a guarantee fee as established by the Agency.

(ix) The refinance loan may be subject to an annual fee as established by the Agency; and

(x) The Agency may limit the number of guaranteed loans made for refinancing purposes based on market conditions and other appropriate factors.

#### § 3555.102 Loan restrictions.

A guarantee will not be issued if loan funds are to be used for:

(a) Existing manufactured homes. Purchase of an existing manufactured home, except as provided in § 3555.208(b)(3);

(b) Income producing land or buildings. Purchase or improvement of land or buildings that are typically used principally for income-producing purposes;

(c) Business or income-producing enterprise. Purchase or the construction of buildings which are largely or in part specifically designed to accommodate a business or income-producing enterprise;

(d) Loan discount points. Loan discount points, except as provided in § 3555.101(b)(6)(vi);

(e) Refinancing. Refinancing, except as provided in § 3555.101(d);

(f) Buydown. Establishing a buydown account;

(g) Lease. Payments on a lease; or

(h) Seller concessions. Purchasing a home if the seller, or other interested third party, contributes more than 6 percent, unless otherwise provided by the Agency, of the property's sales price toward the purchaser's mortgage financing costs, closing costs, escrow accounts, furniture or other giveaways.

§ 3555.103 Maximum loan amount.

The amount of the loan must not exceed the lesser of:

(a) Market value. The market value of the property as determined by an appraisal that meets Agency requirements plus the amount of the up-front loan guarantee fee required by § 3555.107(f), or

(b) Purchase price and acquisition costs. The total of the purchase price and all eligible acquisition costs as permitted by § 3555.101.

(c) Newly constructed dwelling – limited to 90 percent. A newly constructed dwelling that does not meet the definition of an existing dwelling, as defined at §

3555.10, and cannot meet the inspection and warranty requirements of § 3555.202(a) of this subpart is limited to 90 percent of the present market value. The dwelling must meet or exceed the International Energy Conservation Code (IECC) in effect at the time of construction.

§ 3555.104 Loan terms.

(a) Interest rate. The loan must be written at an interest rate that:

(1) Is fixed over the term of the loan;

(2) Shall be negotiated between the lender and borrower to allow the borrower to obtain the best available rate available;

(3) Does not exceed the greater of the Fannie Mae or Freddie Mac rate for 30 year fixed rate conventional loans, as authorized in Exhibit B of subpart A of part 1810 of this chapter (RD Instruction 440.1, available in any Rural Development office) or online at: [http://www.rurdev.usda.gov/rd\\_instructions.html](http://www.rurdev.usda.gov/rd_instructions.html) and

(4) If the interest rate increases between the time of the issuance of the conditional commitment and the loan closing, the lender will note the change in the loan closing package and submit appropriate updated documentation and underwriting analysis to confirm that the applicant is still eligible.

(b) Repayment period. The term of the loan may not exceed 30 years. Adjustable rate mortgages, balloon term mortgages or mortgages requiring prepayment penalties are ineligible terms.

(c) Repayment schedule. Amortized payments will be due and payable monthly.

(d) Negative amortization. The loan note must not provide for interest on interest.

§ 3555.105 Combination construction and permanent loans.

Guarantees of combination construction and permanent loans are subject to the following conditions:

(a) Lender requirements. In addition to other lender requirements of this part, lenders seeking guarantees of combination construction and permanent loans must:

(1) Have two or more years experience making and administering construction loans.

(2) Submit an executed construction contract with each loan application package.

(3) Review and approve construction contractors or builders. The lender will conduct due diligence investigations to determine that the contractor or builder meets the minimum requirements in paragraph (b) of this section. Evidence of the contractor or builder's compliance must be made available by the lender upon request of the Agency.

(4) Close the loan prior to the start of construction with proceeds disbursed to cover the cost of, or balance owed on, the land and the balance into escrow.

(5) Pay out monies from escrow to the builder during construction. The lender must obtain written approval from the borrower before each draw payment is provided to the builder. The borrower and lender are jointly responsible for approving disbursements during the construction phase. The lender must ensure that the appropriate work has been completed prior to releasing each draw. The Agency may require the lender to submit a draw and disbursement ledger for any loan guarantee upon request.

(6) Obtain documentation that confirms the construction of the subject property is complete.

(b) Contractor or builder requirements. Contractors or builders of homes financed with guaranteed combination construction and permanent loans must at least have:

(1) Two or more years experience building or constructing all aspects of single family dwellings similar to the type of project being proposed;

(2) State-issued construction or contractor licenses, as required by State or local law;

(3) Insurance for commercial general liability of at least \$500,000;

(4) Acceptable credit histories free of judgments, collections, or liens related to previous projects the contractor was involved with in the past;

(5) No criminal history based on a criminal background check conducted by the lender;

(6) Limited to 25 units per year unless approved by the Agency; and

(7) Contractors or builders who are constructing their own residence are ineligible.

(c) Use of loan funds. (1) The loan is to finance the construction and purchase of a single family housing residence. Condominiums and manufactured homes are ineligible for combination construction and permanent loans.

(2) The loan amount may include:

(i) The price of the lot.

(ii) Reasonable and customary construction costs related to the construction administration, such as architectural and engineering fees, building permits and fees, surveys, title updates, contingency reserves, not exceeding a percentage specified by the Agency of the cost of construction, draw control and inspection fees, builder's risk insurance or course of construction insurance, and landscaping costs;

(iii) Reasonable and customary closing costs as defined at §3555.101; and

(3) Funds remaining after full disbursement of construction costs will be applied by the lender as a principal payment. Borrowers are not to receive funds after closing except that the borrower may receive funds remaining from certain unused prepaid expenses if the borrower used personal, non-loan funds to pay those expenses.

(d) Terms. The following terms apply to guarantees of combination construction and permanent loans:

(1) The interest rate for the construction and permanent loan will be established in accordance with § 3555.104 at the time the rate is locked, which must occur prior to closing.

(2) The fair market value of the proposed property to be constructed will be used to establish the maximum loan amount.

(3) Annual guarantee fees will begin in the month immediately following loan closing and will not be affected by loan reamortization following the completion of construction. Lenders may fund a lender imposed escrow account for borrower payment of the annual fee in accordance with § 3555.101(b)(6)(xi), as an eligible loan purpose, provided the market value of the property is not exceeded.

(4) Interest on the construction loan is payable monthly either directly from the borrower or indirectly drawn from an established interest reserve. Real estate taxes and property insurance due during the construction period may also be paid using the same draw process. The annual fee will be due and payable from the lender on the 1<sup>st</sup> of the month following the anniversary date the construction to permanent loan closed.

(5) Initial payment of the regularly scheduled (amortized) principal and interest payment may be postponed up to one year, if necessary, based upon the construction period. Local conditions and the proposed construction contract may dictate the term.

(6) The loan will be modified and re-amortized to achieve full repayment within its remaining term once construction is complete. Within a reasonable time, as specified by the Agency, after the final inspection, the borrower will begin making regularly scheduled (amortized) principal and interest payments once the loan is re-amortized.

(e) Mortgage file documentation. Standard industry credit and verification documents may be utilized when processing and closing the loan and must be dated within a reasonable time, specified by the Agency, of the closing in order to be considered valid. In addition to documentation noted at § 3555.202(a), lenders must obtain and retain evidence:

- (1) The actual cost to construct the subject dwelling;
- (2) The acquisition, transfer of ownership, and/or ownership of land;
- (3) Certification of construction completion and that construction costs have been fully drawn;
- (4) Closing costs;



(5) Certification that property is free and clear of all other liens after conversion to permanent loan;

(6) Required inspections and warranties; and

(7) Loan modification agreement when construction is complete confirming the existence of the permanent loan and the amortizing interest rate on the loan.

(f) Loan Note Guarantee. The Loan Note Guarantee will be issued after closing of the construction loan without waiting for complete construction of the subject property upon:

(1) Request by the approved lender;

(2) The lender's submission of the closing documentation acceptable to Rural Development demonstrating that the loan was properly closed;

(3) Payment of the guarantee fee; and

(4) The lender's compliance with other requirements under § 3555.107.

(g) Unplanned changes during construction. Should an unplanned change occur with the borrower or contractor preventing completion of construction, the lender remains responsible for completion of improvements satisfactory to Rural Development. The loan will be serviced in accordance with subparts F and G of this part.

(h) Reservation of funding. Rural Development reserves the right to limit the number or amount of loans guaranteed under this section based on market conditions and other factors it considers appropriate, such as loan and portfolio performance.

§ 3555.106 [Reserved]

§ 3555.107 Application for and issuance of the loan guarantee.

(a) Processing of applications. Except as provided in this section, Rural Development will process loan guarantee applications in the order that completed applications are received. Application forms and instruction procedures are available at any Rural Development office.

(1) If analysis of the utilization of funds during the fiscal year indicates that, at the rate of current utilization, funds may not be sufficient to sustain that level of activity for the remainder of the fiscal year, the Agency may determine a shortage of funds exists.

(2) When there is a shortage of funds, the Agency will limit SFHGLP loans to first-time homebuyers or veterans. First-time homebuyers and veterans will be served in the order their applications are received.

(b) Automated underwriting. Rural Development will offer approved lenders an automated system, if available; to process Rural Development guaranteed loans under this part. The automated underwriting system is a tool to help evaluate credit risk, but does not substitute or replace the careful judgment of experienced underwriters, and shall not be the exclusive basis for a determination on whether to extend credit. The lender must apply for and receive approval from Rural Development to utilize the automated underwriting system. Application forms are available from Rural Development. Lenders using the automated underwriting system shall do so in accordance with SFHGLP regulations and guidelines. Rural Development reserves the right to terminate the lender's use of the automated underwriting system.

(1) Lenders who utilize the Rural Development automated underwriting system remain responsible for ensuring all data is true and accurately represented.

(2) Full documentation and verification, in accordance with Subparts C, D and E of this part, will be retained in the lender's permanent loan file and must confirm the applicant's eligibility, creditworthiness, repayment ability, eligible loan purpose, sufficient collateral, and all other regulatory requirements.

(3) Lenders who utilize the Rural Development automated underwriting system will be subject to indemnification requirements in accordance with § 3555.108.

(4) If a loan receives an "Accept" underwriting recommendation, the lender is generally permitted to submit minimal documentation including the appraisal, flood hazard determination and fully executed request for guarantee, unless the lender is instructed to provide other documentation.

(5) Loan requests that receive a "Refer" or "Refer with Caution" underwriting recommendation require further review and manual underwriting by the lender to determine whether the applicant meets SFHGLP eligibility requirements.

(6) Lenders who utilize Rural Development's automated underwriting system will validate findings, based upon the output report of the underwriting system.

(7) The final submission of the last scoring event must be retained in the lender's permanent loan file.

(c) Manual underwriting. Lenders may utilize a manual underwriting method. Full documentation and verification, in accordance with Subparts C, D and E of this part will be submitted to Rural Development when requesting a guarantee and maintained in the lender's file. The documentation will confirm the applicant's eligibility, creditworthiness, repayment ability, eligible loan purpose, adequate collateral, and satisfaction of other regulatory requirements.

(d) Appraisals. The lender must supply a current appraisal report of the property for which the guarantee is requested.

(1) Appraisals must be conducted in accordance with the Uniform Standards of Professional Appraisal Practices.

(2) Approved lenders are responsible for selecting a qualified appraiser and the integrity, accuracy and thoroughness of the appraisals used to support their loan guarantee request.

(3) The appraiser must report all readily observable property deficiencies, potential environmental hazards, as well as any adverse conditions discovered performing the research involved in completing the appraisal.

(4) The Agency will conduct reviews of the appraisals prior to issuance of the conditional commitment, and other reviews may be conducted to ensure overall quality of appraisals. The lender is responsible for correcting any appraisal deficiencies reported by the Agency.

(5) The Agency may determine an appraiser ineligible to conduct appraisals for SFHGLP due to the failure to comply with applicable requirements and regulations. Appraisals from the ineligible appraisers will not be accepted.

(6) Use of an alternative approach to value for appraisals performed in remote rural areas, on tribal lands, or where a lack of market activity exists may be accepted at the Agency's discretion.

(7) The validity period of an appraisal will be 120 days, unless otherwise provided by the Agency.

(e) Environmental requirements. The lender and Rural Development will meet all environmental responsibilities in accordance with § 3555.5.

(f) Issuance of a conditional commitment. The lender must demonstrate that all the general loan, applicant, and site eligibility requirements of this part are met before Rural Development will issue a conditional commitment. The lender, however, may obtain any required property inspection reports, such as a well test or construction phase inspections, if applicable and not needed for environmental compliance, after the issuance of the conditional commitment, but prior to loan closing.

(1) The conditional commitment will expire in 90 days from issuance, unless new construction is involved.

(2) The expiration of a conditional commitment may coincide with projected completion of new construction.

(3) An extension may be granted if the loan cannot be closed due to circumstances beyond the lender's control.

(4) Lenders may accept or decline the conditional commitment, or submit requests for changes with adequate support and documentation to be reviewed by the Agency.

(g) Loan guarantee fee. The lender must pay a nonrefundable up-front guarantee fee, the cost of which may be passed on to the borrower. The up-front guarantee fee will not exceed 3.5 percent of the principal obligation. The current guarantee fee is available at any Rural Development office and may change periodically. Notice of a change in fee will be published as authorized in Exhibit K of subpart A of part 1810 of this chapter (RD Instruction 440.1, available in any Rural Development office) or online at:

[http://www.rurdev.usda.gov/rd\\_instructions.html](http://www.rurdev.usda.gov/rd_instructions.html). Once the guarantee has been issued, the fee will not be refunded.

(h) Annual fee. The Agency may impose an annual fee of the lender not to exceed 0.5 percent of the average annual scheduled unpaid principal balance of the loan for the life of the loan to allow the Agency to reduce the up-front guarantee in § 3555.107(g). The annual fee will be applicable to purchase and refinance loan transactions. The annual fee may be passed on to the borrower by the lender. The Agency may assess a late charge to the lender if the annual fee is not paid by the due date, and the late charge may be passed on to the borrower. Further administrative guidance is provided in the handbook.

(i) Proper closing and requesting the loan note guarantee. The lender must ensure that any loan to be guaranteed is properly closed using documents acceptable to Rural Development.

(1) Within 30 days of loan closing, the lender must request issuance of a loan guarantee.

(2) The lender will certify the loan was closed in accordance with the conditional commitment and that no major changes have taken place since issuance of a commitment, except any changes specifically approved by the Agency.

(3) The lender will maintain evidence of hazard insurance and, if applicable, flood insurance.

(4) Evidence of documentation supporting the properly closed loan may be submitted to the Agency through regular mail, express mail, facsimile or secure e-mail.

Rural Development may offer approved lenders an automated method of submitting properly closed loans.

(5) Lenders will submit full documentation supporting a closed loan or evidence of self-certification status, as described in this section. Self-certified lenders must still submit the settlement statement and promissory note. Lenders must obtain written authorization from the Agency prior to submitting evidence of self-certification in lieu of full documentation. Authorization for self-certification may be granted by the Agency if:

(i) The lender has an active lender agreement.

(ii) The lender is actively engaged in originating SFHGLP loans and has closed a minimum of 10 loans in the past 12 months.

(iii) The lender has successfully submitted 10 consecutive loan closing to the Agency that were in compliance with loan closing requirements and procedures.

(iv) The lender agrees to retain evidence of confirmed closing conditions in accordance with the issued conditional commitment in the lender's permanent loan file.

(j) Issuance of the guarantee. The loan guarantee does not take effect until:

(1) The lender transmits the required up-front guarantee fee, the lender certification form provided by Rural Development, and loan closing documents to Rural Development;

(2) The lender meets all other conditions set out in the conditional commitment;

(3) The loan is current at the time the lender requests the loan guarantee;

(4) Any construction or rehabilitation, is complete except for development described in §§ 3555.101(c) and 3555.202(c); and

(5) Rural Development issues the loan guarantee document.

§ 3555.108 Full faith and credit.

(a) General. The Loan Note Guarantee constitutes an obligation supported by the full faith and credit of the United States and is incontestable except for fraud or misrepresentation of which the lender has actual knowledge at the time it becomes such lender or which the lender participates in or condones. Misrepresentation includes negligent misrepresentation.

(b) Interest. A note that provides for the payment of interest on interest, however, shall not be guaranteed. If the note to which the Loan Note Guarantee is attached or relates provides for the payment of interest on interest, then the Loan Note Guarantee is void. Notwithstanding the prohibition of interest on interest, interest may be capitalized in connection with re-amortization under subpart G of this part.

(c) Violations. The Loan Note Guarantee will be unenforceable by the lender to the extent any loss is occasioned by violation of usury laws, civil rights laws, negligent servicing, failure to obtain the required security or use of loan funds for unauthorized purposes, regardless of the time at which Rural Development acquires knowledge of the foregoing. Negligent servicing is defined as servicing that is inconsistent with this subpart and includes the failure to perform those services which a reasonably prudent Lender would perform in servicing its own loan portfolio of loans that are not guaranteed. The term includes not only the concept of a failure to act, but also not acting in a timely manner or acting contrary to the manner in which a reasonably prudent Lender would act up to the time of loan maturity or until a final loss is paid.



(d) Indemnification. If the Agency determines that a lender did not originate a loan in accordance with the requirements in this part and the Agency pays a claim under the loan guarantee, the Agency may revoke the lender's eligibility status in accordance with subpart B of this part and may also require the lender:

(1) To indemnify the Agency for the loss, if the payment under the guarantee was made within 24 months of loan closing; or:

(2) To indemnify the Agency for the loss regardless of how long ago the loan closed, if the Agency determines that fraud or misrepresentation was involved in connection with the origination of the loan.

§§ 3555.109 - 3555.149 [Reserved]

§ 3555.150 OMB control number.

The report and recordkeeping requirements contained in this subpart are currently with the Office of Management and Budget under review and awaiting approval.

#### Subpart D - Underwriting the Applicant

§ 3555.151 Eligibility requirements.

(a) Income eligibility. At the time of loan approval, the household's adjusted income must not exceed the applicable moderate income limit. The lender is responsible for documenting the household's income to determine eligibility for the SFHGLP.

(b) Citizenship status. Applicants must provide evidence acceptable to the Agency of their status as United States citizens, U.S. non-citizen nationals, or qualified aliens, as defined in § 3555.10.

(c) Principal residence. Applicants must agree and have the ability to occupy the dwelling as their principal residence. The Agency may require evidence of this ability. Rural Development will not guarantee loans for investment properties, or temporary, short-term housing.

(d) Adequate dwelling. The dwelling must be modest, decent, safe, and sanitary.

(e) Eligibility of current homeowners. Current homeowners may be eligible for guaranteed home loans under this part if all the following conditions are met:

(1) The applicants are not financially responsible for another Agency guaranteed or direct home loan by the time the guaranteed home loan is closed;

(2) The current home no longer adequately meets the applicants' needs;

(3) The applicants will occupy the home financed with the SFHGLP loan as their primary residence;

(4) The applicants are without sufficient resources or credit to obtain the dwelling on their own without the guarantee;

(5) No more than one single family housing dwelling other than the one associated with the current loan request may be retained; and

(6) The applicants must be financially qualified to own more than one home. In order for net rental income from the retained dwelling to be considered for the applicant's repayment ability, the consistency of the rental income must be demonstrated for at least

the previous 24 months, and the current lease must be for a term of at least 12 months after the loan is closed.

(f) Legal capacity. Applicants must have the legal capacity to incur the loan obligation, or have a court-appointed guardian or conservator who is empowered to obligate the applicant in real estate matters.

(g) Suspension or debarment. Applicants who are suspended or debarred from participation in Federal programs under 2 CFR parts 180 and 417 are not eligible for loan guarantees.

(h) Repayment ability. Applicants must demonstrate adequate repayment ability. Lenders must maintain documentation supporting the repayment ability analysis in the loan file. Refer to § 3555.152(a) for further information.

(1) A repayment ratio will be used to determine an applicant's ability to repay a loan. The Agency will utilize two ratios, principal, interest, taxes and insurance (PITI) ratio and total debt (TD) ratio, to determine adequate repayment for the requested loan. The Agency reserves the right to consider calculation of a single ratio in determining repayment for the requested loan.

(i) An applicant is considered to have adequate repayment ability when the monthly amount required for payment of PITI, homeowners' association dues, the monthly calculation of an annual fee, as applicable, and other real estate assessments does not exceed 29 percent of the applicant's repayment income and the monthly amount of PITI plus recurring monthly debts (total debt) does not exceed 41 percent of the applicant's repayment income.

(ii) For home purchases under the Rural Energy Plus provision of § 3555.209, the Agency reserves the right to allow flexibility in the PITI and TD ratio. The handbook will define what flexibilities can be extended.

(iii) Contributions to personal income taxes, retirement accounts (including the repayment of personal loans from those retirement accounts), savings (including repayment of loans secured by such funds), the cost to commute, membership fees in unions or like organizations, childcare or other voluntary obligations will not be considered in the TD ratio.

(iv) Except for obligations specifically excluded by State law, the debts of non-purchasing spouse must be included in the applicant's repayment ratios if the applicant resides in a community property state.

(2) The repayment ratio may exceed the percentage specified in paragraph (h)(1) of this section if certain compensating factors exist. The handbook will define when a debt ratio may be granted. The automated underwriting system will take into account any compensating factors in determining whether the variance is appropriate. For manually underwritten loans, the lender must document compensating factors demonstrating that the household has higher repayment ability based on its capacity, willingness and ability to pay mortgage payments in a timely manner. The presence of compensating factors does not strengthen a ratio exception when multiple layers of risk, such as a marginal credit history, are present in the application. Acceptable compensating factors and supporting documentation for a proposed debt ratio waiver will be further defined and clarified in the handbook. Compensating factors include, but are not limited to:

(i) A credit score at an acceptable level of 680 or higher for any applicants, unless otherwise provided by the Agency. The Agency reserves the right to change the acceptable level of credit score.

(ii) A minimal increase in housing expense, i.e. the current rent payment is comparable to the proposed mortgage loan payment PITI and if applicable, homeowner association dues.

(iii) The demonstrated ability to accumulate savings and cash reserves post loan closing.

(iv) Continuous employment with a current primary employer.

(3) Loan ratio exceptions require written approval by Rural Development, or acceptance by an Agency approved automated underwriting system. Flexibilities surrounding loan ratio exceptions will be further clarified in the handbook. Lenders with loans accepted by an Agency approved automated underwriting system need not submit documentation for the need for a ratio waiver.

(4) If an applicant does not meet the repayment ability requirements, the applicant can increase repayment ability by having other eligible household members join the application.

(5) Mortgage Credit Certificates may be considered in determining an applicant's repayment ability.

(6) Section 8 Homeownership Vouchers may be used in determining an applicant's repayment ability. The monthly subsidy may be treated as repayment income in accordance with § 3555.152(a) or offset in the PITI.

(7) A funded buydown account may be used to reduce the borrower's monthly mortgage payment during the early years of repayment when all of the following requirements are met:

(i) The loan will be underwritten at the note rate.

(ii) The interest rate may be bought down to no more than 2 percentage points below the note rate.

(iii) The interest rate paid by the borrower may increase no more frequently than annually.

(iv) The interest rate paid by the borrower may increase no more than 1 percentage point annually.

(v) Funds must be placed in an escrow account with monthly releases scheduled directly to the lender.

(vi) Funds must be placed with a Federal- or state-regulated lender.

(vii) The escrow account must be fully funded for the buydown period.

(viii) The borrower is not permitted to use personal funds or funds borrowed from another source to establish the escrow account for the buydown.

(ix) The borrower must not be required to borrow or repay the funds.

(i) Credit qualifications. Applicants generally must have a verifiable credit history that indicates a reasonable ability and willingness to meet their debt obligations as evidenced by an acceptable credit score, a credit report from a recognized credit repository meeting the requirements of Fannie Mae, Freddie Mac, FHA or VA, and other credit qualifications satisfactory to Rural Development.

(1) Except as provided in paragraph (i)(6) of this section, the applicant's credit history must demonstrate a past willingness and ability to meet credit obligations to enable the lender to evaluate each applicant and draw a logical conclusion about the applicant's commitment and ability to handling financial obligations successfully and ability to make payments on the new mortgage obligation.

(2) Loans acceptance by an Agency approved automated underwriting system eliminates the need for the lender to submit documentation of the credit qualification decision as loan approval requirements will be incorporated in the automated system.

(3) For manually underwritten loans, lenders must submit documentation of the credit qualification decision. Lenders will use credit scores to manually underwrite loan mortgage requests. Lenders are required to validate the credit scores utilized in the underwriting determination. Indicators of significant derogatory credit will require further review and documentation of that review. Indicators of significant derogatory credit include, but are not limited to:

(i) A foreclosure that has been completed in the 36 months prior to application by the applicant.

(ii) A bankruptcy in which debts were discharged within 36 months prior to the date of application by the applicant. Applicants who have completed a bankruptcy debt restructuring plan must have completed the plan and demonstrated a willingness to meet obligations when due for greater than the 12 months prior to the date of application by the applicant.

(iii) One rent or mortgage payment paid 30 or more days late within the last 12 months prior to application by the applicant.

(iv) A previous Agency loan that resulted in a loss to the Government.

(4) When evidence of significant derogatory credit is present, lenders may consider extenuating circumstances, including but not limited to, whether the problems were caused by factors temporary in nature, if the circumstances leading to the derogatory credit were beyond the control of the applicant, and if the loan would significantly reduce the applicant's housing expenses.

(5) In all cases, the applicant cannot have an outstanding Federal judgment, other than a judgment obtained in the United States Tax Court, or a delinquent non-tax Federal debt that has not been paid in full or otherwise satisfied.

(6) For applicants without an established credit history, alternative methods may be used to evidence an applicant's willingness to pay, such as a non-traditional mortgage credit report or multiple independent verifications of trade references.

(7) A credit report for a non-purchasing spouse must be obtained in order to determine the debt-to-income ratio referenced at § 3555.151(h) if the applicant resides in a community property state.

(8) Lenders are encouraged to offer or provide for home ownership counseling. Lenders may require first-time homebuyers to undergo such counseling if it is reasonably available in the local area. When home ownership counseling is provided or sponsored by Rural Development or another Federal agency in the local area, the Lender must require the borrower to successfully complete the course.

(j) Obtaining credit. The applicant must be unable to obtain traditional conventional mortgage credit, as defined by the Agency, for the subject loan.



§ 3555.152 Calculation of income and assets.

The lender must obtain and maintain documentation in the loan file supporting the lender's determination of all income and assets described in this section.

(a) Repayment income. Repayment income is the amount of adequate and stable income from all sources that parties to the promissory note are expected to receive.

Repayment income is used to determine the applicant's ability to repay a loan.

(1) The lender must examine the applicant's past income record for at least the past 2 years and any applicable training and/or education. The Agency may require additional information and documentation from self-employed applicants and applicants employed by businesses owned by family members.

(2) The lender must establish an applicant's anticipated amount of repayment income and the likelihood of its continuance for at least the next 3 years to determine an applicant's capacity to repay a requested mortgage loan in accordance with

§ 3555.151(h)(1).

(3) Income may not be used in calculating an applicant's ratios if it is from any source that cannot be verified, is not stable, or is likely not to continue.

(4) The following types of income are examples of income not included in repayment income:

(i) Any student financial aid received by household members for tuition, fees, books, equipment, materials, and transportation;

(ii) Amounts received that are specifically for, or in reimbursement of the cost of medical expenses for any family member;

(iii) Temporary, nonrecurring, or sporadic income (including gifts);

(iv) Lump sum additions to family assets such as inheritances, capital gains, insurance payments and personal or property settlements;

(v) Payments for the care of foster children or adults; and

(vi) Supplemental Nutrition Assistance Program payments.

(b) Annual income. Annual income is the income of all household members, regardless of whether they will be parties to the promissory note.

(1) Applicants must provide the income, expense and household information necessary to enable the lender to make income determinations.

(2) Lenders must verify employment and income information provided by the applicant for all household members. Lenders will verify the income for each adult household member for the previous 2 years. Written or oral verifications provided by third-party sources or documents prepared by third-party sources are acceptable. Lenders must project the expected annual income for the next 12 months from the verified sources.

(3) The lender remains responsible for the quality and accuracy of all information used to establish a household's eligibility.

(4) Household income from all sources including, but not limited to, income from temporarily absent household members, allowances for tax-exempt income and net family assets as defined in paragraph (d) of this section are to be considered in the calculation of annual income.

(5) The following sources of income will not be considered in the calculation of annual income:

- (i) Earned income of persons under the age of 18 unless they are an applicant or a spouse of a member of the household;
- (ii) Payments received for the care of foster children or foster adults and incomes received by foster children or foster adults who live in the household;
- (iii) Amounts granted for, or in reimbursement of, the cost of medical expenses;
- (iv) Earnings of each full-time student 18 years of age or older, except the head of household or spouse, that are in excess of any amount determined pursuant to HUD definition of annual income at 24 CFR 5.609(c);
- (v) Temporary, nonrecurring, or sporadic income (including gifts);
- (vi) Lump sum additions to family assets such as inheritances; capital gains; insurance payments under health, accident, or worker's compensation policies; settlements for personal or property losses; and deferred periodic payments of supplemental social security income and Social Security benefits received in a lump sum;
- (vii) Any earned income tax credit;
- (viii) Adoption assistance in excess of any amount determined pursuant to HUD's definition of annual income at 24 CFR 5.609(c);
- (ix) Amounts received by the family in the form of refunds or rebates under State or local law for property taxes paid on the dwelling;
- (x) Amounts paid by a State agency to a family with a developmentally disabled family member living at home to offset the cost of services and equipment needed to keep the developmentally disabled family member at home;
- (xi) The full amount of any student financial aid;

(xii) Any other revenue exempted by a Federal statute, a list of which is available from any Rural Development office;

(xiii) Income received by live-in aides, regardless of whether the live-in aide is paid by the family or a social service program;

(ix) Employer-provided fringe benefit packages unless reported as taxable income; and

(x) Amounts received through the Supplemental Nutrition Assistance Program.

(c) Adjusted annual income. Adjusted annual income is used to determine program eligibility and is annual income as defined in paragraph (b) of this section, less any of the following verified deductions for which the household is eligible.

(1) A reduction for each family member, except the head of household or spouse, who is under 18 years of age, 18 years of age or older with a disability, or a full-time student, the amount of which will be determined pursuant to HUD definition of adjusted income at 24 CFR 5.611.

(2) A deduction of reasonable expenses for the care of a child 12 years of age or under that:

(i) Enables a family member to work, to actively seek work, or to further a member's education;

(ii) Are not reimbursed or paid by another source; and

(iii) In the case of expenses to enable a family member to work, do not exceed the amount of income, including the value of any health benefits, earned by the family member enabled to work. If the child care provider is a household member, the cost of the children's care cannot be deducted.

(3) A deduction of reasonable expenses related to the care of household members with disabilities that:

(i) Enable a family member or the individual with disabilities to work, to actively seek work, or to further a member's education;

(ii) Are not reimbursed from insurance or another source; and

(iii) Are in excess of 3 percent of the household's annual income and do not exceed the amount of earned income included in annual income by the person who is able to work as a result of the expenses.

(4) For any elderly family, a deduction in the amount determined pursuant to HUD definition of adjusted income at 24 CFR 5.611.

(5) For elderly and disabled families only, a deduction for household medical expenses that are not reimbursed from insurance or another source and which, in combination with any expenses related to the care of household members with disabilities described in paragraph (c)(3) of this section, are in excess of 3 percent of the household's annual income.

(d) Net family assets. For the purpose of computing annual income, the net family assets of all household members must be included in the calculation of annual income.

Lenders must document and verify assets of all household members.

(1) Net family assets include, but are not limited to, the actual or imputed income from:

(i) Equity in real property or other capital investments, other than the dwelling or site;

(ii) Cash on hand and funds in savings or checking accounts;

- (iii) Amounts in trust accounts that are available to the household;
- (iv) Stocks, bonds, and other forms of capital investments that is accessible to the applicant without retiring or terminating employment;
- (v) Lump sum receipts such as lottery winnings, capital gains, and inheritances;
- (vi) Personal property held as an investment; and
- (vii) Any value, in excess of the consideration received, for any business or household assets disposed of for less than fair market value during the 2 years preceding the income determination. The value of assets disposed of for less than fair market value shall not be considered if they were disposed of as a result of foreclosure, bankruptcy, or a divorce or separation settlement.

(2) Net family assets for the purpose of calculating annual income do not include:

- (i) Interest in American Indian restricted land;
- (ii) Cash on hand which will be used to reduce the amount of the loan;
- (iii) The value of necessary items of personal property;
- (iv) Assets that are part of the business, trade, or farming operation of any member of the household who is actively engaged in such operation;
- (v) Amounts in voluntary retirement plans such as individual retirement accounts (IRAs), 401(k) plans, and Keogh accounts (except at the time interest assistance is initially granted);
- (vi) The value of an irrevocable trust fund or any other trust over which no member of the household has control;
- (vii) Cash value of life insurance policies; and
- (viii) Other amounts deemed by the Agency not to constitute net family assets.

§§ 3555.153 - 3555.199 [Reserved]

§ 3555.200 OMB control number.

The report and recordkeeping requirements contained in this subpart are currently with the Office of Management and Budget under review and awaiting approval.

#### Subpart E - Underwriting the Property

§ 3555.201 Site requirements.

(a) Rural areas. Rural Development will only guarantee loans made in rural areas designated as rural by Rural Development. However, if a rural area designation is changed to nonrural:

- (1) Existing conditional commitments in the former rural area will be honored;
- (2) A supplemental loan may be made in accordance with §3555.101 in conjunction with a transfer and assumption of a guaranteed loan;
- (3) Loan requests where the application and purchase contract was complete prior to the area designation change may be approved; and
- (4) REO property sales and transfers with assumption may be processed.

(b) Site standards. Sites must be modest and developed in accordance with any standards imposed by a State or local government and must meet all of the following requirements.

- (1) The site size must be typical for the area.

(2) The site must not include income-producing land or buildings to be used principally for income-producing purposes. Vacant land without eligible residential improvements, or property used primarily for agriculture, farming or commercial enterprise is ineligible for a loan guarantee.

(3) The site must be contiguous to and have direct access from a street, road, or driveway. Streets and roads must be hard surfaced or all weather surfaced and legally enforceable arrangements must be in place to ensure that needed maintenance will be provided.

(4) The site must be supported by adequate utilities and water and wastewater disposal systems. Certain water and wastewater systems that are privately-owned may be acceptable if the lender determines that the systems are adequate, safe, compliant with applicable codes and requirements, and the cost or feasibility to connect to a public or community system is not reasonable. Certain community-owned water and wastewater systems may be acceptable if the lender determines that the systems are adequate, safe, and compliance with applicable codes and requirements. The Agency may require inspections on individual, central, or privately-owned and operated water or waste systems.

§ 3555.202 Dwelling requirements.

(a) New dwellings. New dwellings must be constructed in accordance with certified plans and specifications, and must meet or exceed the International Energy Conservation Code (IECC) in effect at the time of construction. The lender must obtain



and retain evidence of construction costs, inspection reports, certifications, and builder warranties acceptable to Rural Development.

(b) Existing dwellings. Existing dwellings are considered to meet the following criteria when inspected and certified as meeting HUD requirements for one-to-four unit dwellings in accordance with Agency guidelines:

- (1) Be structurally sound;
- (2) Be functionally adequate;
- (3) Be in good repair, or to be placed in good repair with loan funds; and
- (4) Have adequate and safe electrical, heating, plumbing, water, and wastewater disposal systems.

(c) Escrow account for exterior or interior development. This paragraph does not apply if the development is related to a “combination construction and permanent loan” under § 3555.101(c). If a dwelling is complete with the exception of interior or exterior development work, Rural Development may issue the Loan Note Guarantee on the loan if the following conditions are met:

(1) The incomplete work does not affect the habitability of the dwelling, nor the health or safety of the housing occupants.

(2) The cost of any remaining interior or exterior work is not greater than 10 percent of the final loan amount.

(3) An escrow account is funded in an amount sufficient to assure the completion of the remaining work. This figure must be at least 100 percent of the cost of completion but may be higher if the lender determines a higher amount is needed.

(4) The builder or a licensed contractor has executed a contract providing for completion of the planned development within 180 days of loan closing. If the borrower will be completing the planned development on an existing dwelling without the services of a contractor, the requirement for an executed contract is waived when all of the following conditions are met:

(i) The estimated cost to complete the work is less than 10 percent of the total loan amount;

(ii) The escrow amount is less than or equal to \$10,000; and

(iii) The lender has determined the borrower has the knowledge and skills necessary to complete the work.

(5) The lender may release escrowed funds only after obtaining a final inspection report acknowledged by the borrower and indicating all planned development has been satisfactorily completed.

(6) The lender remains responsible to ensure a final inspection is performed and required repairs are completed.

(7) The settlement statement reflects the amounts escrowed.

§ 3555.203 Ownership requirements.

After the loan is closed, the borrower must have an acceptable ownership interest in the property as evidenced by one of the following:

(a) Fee-simple ownership. Acceptable fee-simple ownership is evidenced by a fully marketable title with a deed vesting a fee-simple interest in the property to the borrower.

(b) Secured leasehold interest. Loans may be guaranteed on leasehold properties.

If the conditions in this subsection are met:

(1) The applicant is unable to obtain fee simple title to the property;

(2) Such leaseholds are fully marketable in the area, except in the case of properties located on American Indian restricted land;

(3) The lease has an unexpired term of at least 45 years from the date of loan closing, except in the case of properties located on American Indian restricted land where the lease must have an unexpired term at least equal to the term of the loan. Leases on American Indian restricted land for period of 25 years which are renewable for a second 25 year period are permissible as are leases of a longer duration;

(4) The mortgage must cover both the property improvements and the leasehold interest in the land;

(5) The leasehold estate must constitute real property, be subject to the mortgage lien, be insured by a title policy, be assignable or transferable and cannot be terminated except for nonpayment of lease rents; and

(6) The lease must be recorded in the appropriate local real estate records.

§ 3555.204 Security requirements.

Rural Development will only guarantee loans that are adequately secured. A loan will be considered adequately secured only when all of the following requirements are met:

(a) Recorded security document. The lender obtains at closing, a mortgage on all required ownership and leasehold interests in the security property and ensures that the loan is properly closed.

(b) Prior liens. No liens prior to the guaranteed mortgage exist except in conjunction with a supplemental loan for transfer and assumption. The guaranteed loan must have first lien position at closing. Junior liens by other parties are permitted as long as the junior liens do not adversely affect repayment ability or the security for the guaranteed loan.

(c) Adequate security. Existing and proposed property improvements are completely on the site and do not encroach on adjoining property.

(d) Collateral. All collateral secures the entire loan.

§ 3555.205 Special requirements for condominiums.

Loans may be guaranteed for condominium units in condominium projects that meet all the requirements of this part, as well as the standards for condominium standards established by HUD, Fannie Mae, VA, or Freddie Mac, including those related to self-certification, warranty, underwriting, and ineligible condominium projects.

§ 3555.206 Special requirements for community land trusts.

A community land trust must meet the definition in accordance with § 3555.10 and other requirements described in this subpart. Loans may be guaranteed for dwellings on land owned by a community land trust only if:

(a) Rural Development review. Rural Development reviews and accepts any restrictions imposed by the community land trust on the property or applicant before loan closing. The Agency may place conditions on the approval of restrictions on resale price and rights of first refusal.

(b) Foreclosure termination. The community land trust automatically and permanently terminates upon foreclosure or acceptance by the lender of a deed in lieu of foreclosure.

(c) Organization. The organization must meet the definition of a community land trust as defined in the Housing Act of 1949 and the following requirements:

(1) Be organized under State or local laws.

(2) Members, founders, contributors or individuals cannot benefit from any part of net earnings of the organization.

(3) The organization must be dedicated to decent affordable housing for low- and moderate-income people.

(4) Comply with financial accountability.

(d) Lender documentation. The lender's file must contain documentation that the community land trust has community support, local market acceptance and 2 years of prior experience in providing affordable housing.

(e) Appraisals. A property located on a site owned by a community land trust must be appraised as leasehold interest and meet the provisions of § 3555.203.

§ 3555.207 Special requirements for Planned Unit Developments (PUDs).

Loans may be guaranteed for PUDs that meet all of the requirements of this part, as well as the criteria for PUDs established by HUD, VA, Fannie Mae, or Freddie Mac.

§ 3555.208 Special requirements for manufactured homes.

Loans may be guaranteed for manufactured homes if all the requirements in this section are met.

(a) Eligible costs. In addition to the loan purposes described in § 3555.101, Rural Development may guarantee a loan used for the following purposes related to manufactured homes when a real estate mortgage covers both the unit and the site:

(1) Purchase of a new manufactured home, transportation, permanent foundation, and installation costs of the manufactured home, and purchase of an eligible site if not already owned by the applicant; and

(2) Site development work properly completed to HUD, state and local government standards, as well as, the manufacturer's requirements for installation on a permanent foundation.

(b) Loan restrictions. The following loan restrictions are in addition to the loan restrictions contained in § 3555.102:

(1) A loan will not be guaranteed if it is used to purchase a site without also financing a new unit.

(2) A loan will not be guaranteed if it is used to purchase furniture, including but not limited to: movable articles of personal property such as drapes, beds, bedding, chairs, sofas, divans, lamps, tables, televisions, radios, and stereo sets. Furniture does not

include wall-to-wall carpeting, refrigerators, ovens, ranges, washing machines, clothes dryers, heating or cooling equipment, or other similar items.

(3) A loan will not be guaranteed to purchase an existing manufactured home and site unless:

(i) The unit and site are already financed with an Agency direct single family or guaranteed loan;

(ii) The unit and site are being sold by Rural Development as REO property;

(iii) The unit and site are being sold from the lender's inventory, and the loan for which the unit and site served as security was a loan guaranteed by Rural Development; or

(iv) The unit was installed on its initial installation site on a permanent foundation complying with the manufacturer's and HUD installation standards.

(4) A loan will not be guaranteed for repairs to an existing unit, unless the unit meets the requirements of § 3555.208(b)(3).

(5) A loan will not be guaranteed for the purchase of an existing manufactured home that has been moved from another site.

(c) Construction and development. (1) To be an eligible unit, the new unit must have a floor space of not less than 400 square feet.

(2) The unit must be properly installed on a permanent foundation according to HUD standards, and the manufacturer's requirements for installation on a permanent foundation. A certification of proper foundation is required.

(3) All wheels, axles, towing hitches and running gear must be removed from the manufactured home.

(4) Unit construction must conform to the Federal Manufactured Home Construction and Safety Standards (FMHCSS) and be constructed in compliance with the HUD heating and cooling requirements for the State in which the unit will be located. Any alterations, such as garage construction, as a new unit must comply with FMHCSS.

(5) The site development, installation and set-up must conform to the HUD requirements and the manufacturer's requirements for a permanent installation.

(6) The unit must meet or exceed the IECC in effect at the time of construction.

(7) The lender must maintain documentation of construction plans and required certifications.

(d) Warranty requirements. (1) The applicant must receive a warranty in accordance with HUD requirements for new manufactured homes on permanent foundations.

(2) The warranty must identify the unit by serial number.

(3) The lender and applicant must obtain certification that the manufactured home has sustained no hidden damage during transportation and, if manufactured in separate sections that the sections were properly joined and sealed according to the manufacturer's specifications.

(4) The manufactured home must be affixed with a data plate, placed inside the unit, and a certification label, affixed to each transportable section at the tail-light end of each unit which indicates that the home was designed and built in accordance with HUD's construction and safety standards in effect on the date the home was manufactured.



(5) The lender must retain a copy of all manufacturers' warranties in the lender file.

(e) HUD requirements. The FMHCSS and HUD requirements may be found at [http://www.access.gpo.gov/nara/cfr/waisidx\\_04/24cfr3280\\_04.html](http://www.access.gpo.gov/nara/cfr/waisidx_04/24cfr3280_04.html).

(f) Title and lien requirements. To be eligible for the SFHGLP, the following conditions must be met and documented in the lender's file:

(1) A manufactured home loan must be secured by a perfected lien on real property consisting of the manufactured home and the land;

(2) The manufactured home must be taxed as real estate as applicable under State law, including relevant statutes, regulations, and judicial decisions;

(3) The security instrument must be recorded in the land records and must identify the encumbered property as including both the home and the land;

(4) If applicable State law so permits, any certificate of title to the manufactured home must be surrendered to the appropriate State government authority. If the certificate of title cannot be surrendered, the lender must indicate its lien on the certificate;

(5) The mortgage must be covered by a standard real property title insurance policy and any other endorsement required in the applicable jurisdiction for manufactured home ensuring the manufactured home is part of the real property that secures the loan; and

(6) The borrower must acknowledge the unit is a fixture and part of the real estate securing the mortgage.

§ 3555.209 Rural Energy Plus loans.

Loans guaranteed under Rural Energy Plus provisions are for the purchase of energy-efficient homes. Homes that meet the most current IECC standards including existing homes that are retrofitted to those standards are eligible. Energy-efficient homes result in lower utility bills, conserve energy, and thus, make more income available for monthly debt obligations. For loans guaranteed under this subpart, the lender will certify that the home meets the most current IECC standards. The Handbook will define what further flexibilities can be extended.

§§ 3555.210 - 3555.249 [Reserved]

§ 3555.250 OMB control number.

The report and recordkeeping requirements contained in this subpart are currently with the Office of Management and Budget under review and awaiting approval.

Subpart F - Servicing Performing Loans

§ 3555.251 Servicing responsibility.

(a) Servicing action. Lenders must perform those servicing actions that a reasonable and prudent lender would perform in servicing its own portfolio of non-guaranteed loans.

(b) Third party servicer. A lender may contract with a third party to service its loans, but the servicing lender of record remains responsible for the quality and completeness of the servicing.

(c) Transfer of servicing. Rural Development may require a lender to transfer its loan servicing activities to an approved lender if Rural Development determines that the lender has failed to provide acceptable servicing.

(d) Non-compliance. Lenders who fail to comply with Agency requirements or program guidelines may be subject to withdrawal of lender approval, denial and/or reduction in loss claims, withdrawal of the loan guarantee and/or indemnification in accordance with § 3555.108(d).

§ 3555.252 Required servicing actions.

Lender servicing responsibility includes, but is not limited to, the following actions.

(a) Collecting regularly scheduled payments. Lender must collect regularly scheduled loan payments and apply them to the borrower's account.

(b) Payment of taxes and insurance. Lenders must ensure that real estate taxes, assessments, and flood and hazard insurance premiums for all property that secures a guaranteed loan are paid on schedule.

(1) Establish escrow account. Lenders with the capacity to escrow funds must establish escrow accounts for all guaranteed loans for the payment of taxes and insurance.

Escrow accounts must be administered in accordance with the Real Estate Settlement and Procedures Act (RESPA) of 1974, and insured by the FDIC or the NCUA.

(2) Plan and responsibility of lender to ensure payment. Lenders that do not have the capacity to escrow funds must implement procedures, subject to Agency approval, to ensure the borrower pays such obligations on a timely basis. In addition, such lenders must accept the responsibility for payment of taxes and insurance that comes due prior to liquidation. Rural Development will not include any taxes or insurance amounts that accrued prior to acceleration in any potential loss claim. Rural Development may revoke the acceptance of the lender's plan if loan performance indicates that delinquency and loss rates are being affected by the lender's inability to escrow for taxes, assessment, and insurance. This alternative is not available to lenders who contract for servicing.

(c) Insurance. (1) Until the loan is paid in full, lenders must ensure that borrowers maintain hazard and flood insurance as required, on property securing guaranteed loans. The insurance must be issued by companies in amounts, and on terms and conditions, acceptable to Rural Development. Flood insurance through the National Flood Insurance Program must be maintained for all property located in special flood or mudslide areas identified by FEMA and must be consistent with mortgage industry standards, as determined by the Agency.

(2) Lenders must ensure that borrowers immediately notify them of any loss or damage to insured property securing guaranteed loans and collect the amount of the loss from the insurance company. Unless the borrower pays off the guaranteed loan using the insurance proceeds, the following requirements must be met:

(i) All repairs and replacements using the insurance proceeds must be planned, performed, and inspected in accordance with Agency construction requirements and procedures.

(ii) When insurance funds remain after payments for all repairs, replacements, and other authorized disbursements have been made, the funds must be applied in the following order: prior liens (including past-due property taxes); past-due amounts; protective advances; and released to the borrower if the lender's debt is adequately secured.

(3) If the insurance claim is de minimis as determined by the Agency, the lender may release the funds directly to the borrower to advance funds to contractors, provided that the account is current and the borrower has a history of timely payments; the borrower occupies the property; and the borrower executes an affidavit agreeing to apply the funds for repairs or reconstruction of the dwelling.

(d) Credit reporting. The lender must notify a credit repository of each new guaranteed loan, must identify the loan as guaranteed by Rural Development, and must report to that repository whenever any account becomes more than 30 calendar days past due.

(e) Bankruptcy actions. The lender is responsible for monitoring and taking all appropriate and prudent actions during bankruptcy proceedings to protect the borrower and Government's interest, in accordance with § 3555.306(d).

§ 3555.253 Late payment charges.

Late payment charges will not be covered by the guarantee and cannot be added to the principal and interest due under any guaranteed note.

(a) Maximum amount. Any late payment charge must be reasonable and customary for the area.

(b) Loans with interest assistance. The lender must not charge a late fee if the only unpaid portion of the borrower's scheduled payment is interest assistance owed by Rural Development.

§ 3555.254 Final payments.

Lenders may release security instruments only after full payment of all amounts owed, including any recapture, has been received and verified.

§ 3555.255 Borrower actions requiring lender approval.

(a) Mineral leases. A lender may consent to the lease of mineral rights and subordinate its lien to the lessee's rights and interests in the mineral activity if the security property will remain suitable as a residence, the lender's security interest will not be adversely affected, and Rural Development's environmental requirements are met. Concurrence by Rural Development prior to consenting to the lease of mineral rights is required, unless otherwise provided by the Agency. Subordination of guaranteed loans to a mineral lease does not entitle the leaseholder to any proceeds from the sale of the security property.

(1) If the proposed activity is likely to decrease the value of the security property, the lender may consent to the lease only if the borrower assigns 100 percent of the income from the lease to the lender to be applied to reduce the principal balance, and the total rent to be paid is at least equal to the estimated decrease in the market value of the security property.

(2) If the proposed activity is not likely to decrease the value of the security property, the lender may consent to the lease if the borrower agrees to use any damage compensation received from the lessee to repair damage to the site or dwelling, or to assign it to the lender to be applied to reduce the principal balance.

(b) Partial release of security property. A lender may consent to transactions affecting a security property, such as selling or exchanging security property or granting of a right-of-way across the security property, and grant a partial release, provided that the following conditions are met.

(1) The borrower will receive adequate compensation, and either make a reduction to the principal balance or make improvements to the security property, in order to maintain the current loan-to-value ratio for the guaranteed loan.

(i) For sale of security property, the borrower must receive cash in an amount equal to or greater than the value of the security property being sold or interests being conveyed.

(ii) For exchange of security property, the borrower must receive another parcel of property with value equal to or greater than that being disposed of.

(iii) For granting an easement or right-of-way, the borrower must receive benefits that are equal to or greater than the value of the security property being disposed of or interests being conveyed.

(2) An appraisal of the security property will be conducted by the lender if the most current appraisal is more than 1 year old or if it does not reflect current market value.

(3) The security property, after the transaction is completed, will continue to be an adequate, safe, and sanitary dwelling.

(4) Repayment of the guaranteed debt will not be jeopardized.

(5) When exchange of all or part of the security property is involved, title clearance will be obtained before release of the existing security.

(6) Proceeds from the sale of a portion of the security property, granting an easement or right-of-way, damage compensation, and all similar transactions requiring the lender's consent, will be used in the following order:

(i) To pay customary and reasonable costs related to the transaction that must be paid by the borrower.

(ii) To be applied on a prior lien debt, if any.

(iii) To be applied to the guaranteed indebtedness or used for improvements to the security property consistent with the purposes and limitations applicable for use of guaranteed loan funds. The lender must ensure that the proceeds are used as planned.

(7) The lender will seek Agency concurrence, unless otherwise provided by the Agency, by submitting documentation supporting the borrower's reason for request, the proposed use of the land with supporting plans, specifications, cost estimates, surveys,



disclosures of restrictions, legal description modification, title clearance related to the transaction request, as applicable, and any other documents necessary for the Agency to make a determination.

§ 3555.256 Transfer and assumptions.

(a) Transfer without assumption. (1) The lender must notify Rural Development if the borrower transfers the security property and the transferee does not assume the debt.

(2) Except as described in paragraph (d) of this section, if a security property is transferred with the lender's knowledge without assumption of the debt, Rural Development will void the guarantee.

(b) Transfer with assumption. (1) The lender must obtain Agency approval before consenting to a transfer with an assumption of the outstanding debt.

(2) Rural Development may approve a transfer with an assumption of the outstanding debt if the following conditions are met:

(i) The transferee must assume the entire outstanding debt and acquire all property securing the guaranteed loan balance; however, the transferor must remain personally liable. The transferor must pay any recapture as a result of interest subsidy granted, if applicable, owed at the time of the transfer and assumption.

(ii) The transferee must meet the eligibility requirements described in subpart D of this part.

(iii) The property must meet the site and dwelling requirements described in subpart E of this part, or be brought to those standards prior to the transfer. Guaranteed

loans secured by properties located in areas that have ceased to be rural may be assumed notwithstanding the fact that the property is located in a non-rural area.

(iv) The priority of the existing lien securing the guaranteed loan must be maintained or improved.

(v) Any new rates and terms must not exceed the rates and terms allowed for new loans under this part, and the interest rate must not exceed the interest rate on the initial loan.

(vi) A new guarantee fee, calculated based on the remaining principal balance, must be paid to Rural Development in accordance with § 3555.107(f).

(vii) If additional financing is required to complete the transfer and assumption or to make needed repairs, Rural Development may approve a supplemental guaranteed loan provided adequate security exists.

(viii) The lender must verify and document their permanent file in accordance with subpart C of this part.

(ix) A written request supported by the lender demonstrating the applicant's credit worthiness, income eligibility and underwriting analysis must be submitted to the Agency for approval of a transfer and assumption.

(x) The lender may close the loan in accordance with § 3555.107.

(c) Transfer without approval. If a lender becomes aware that a borrower has transferred a property without approval, the lender must take one of the following actions:

(1) Notify Rural Development and continue the loan without the guarantee; or

- (2) Obtain Agency approval for the transfer with assumption; or
- (3) Liquidate the guaranteed loan and submit a claim for any loss.
- (d) Transfer without triggering the due-on-sale clause. (1) The following types of transfers do not trigger due-on-sale clauses in security instruments:
  - (i) A transfer from the borrower to a spouse or children not resulting from the death of the borrower;
  - (ii) A transfer to a relative, joint tenant, or tenant by the entirety resulting from the death of the borrower;
  - (iii) A transfer to a spouse or ex-spouse resulting from a divorce decree, legal separation agreement, or property settlement agreement;
  - (iv) A transfer to a person other than a deceased borrower's spouse who wishes to assume the loan for the benefit of persons who were dependent on the deceased borrower at the time of death, if the dwelling will be occupied by one or more persons who were dependent on the borrower at the time of death, and there is a reasonable prospect of repayment; or
  - (v) A transfer into an inter vivos trust in which the borrower does not transfer rights of occupancy in the property.
- (2) When a transferee obtains a property with a guaranteed loan through a transfer that does not trigger the due-on-sale clause:
  - (i) The lender will notify Rural Development of the transfer;
  - (ii) Rural Development will continue with the guarantee, whether or not the transferee assumes the guaranteed loan;

(iii) The transferee may assume the guaranteed loan on the rates and terms contained in the promissory note. If the account is past due at the time an assumption agreement is executed, the loan may be re-amortized to bring the account current;

(iv) The transferee may assume the guaranteed loan under new rates and terms if the transferee applies and is eligible.

(3) Any subsequent transfer of title, except upon the death of the inheritor or between inheritors to consolidate title, will trigger the due-on-sale clause.

§ 3555.257 Unauthorized assistance.

(a) Unauthorized assistance due to false information. (1) If the borrower receives a guaranteed loan based on false information provided by the borrower, Rural Development may require the lender to accelerate the guaranteed loan. After the lender accelerates the loan upon request, the lender may submit a claim for any loss. If the lender fails to accelerate the loan upon request, Rural Development may reduce or void the guarantee.

(2) If the borrower receives a guaranteed loan based on false information provided by the lender, Rural Development may void the guarantee subject to the provisions of § 3555.108.

(3) If the borrower or lender provides false information, Rural Development may pursue criminal and civil false claim actions, suspension and/or debarment, and take all other appropriate action.

(b) Unauthorized assistance due to inaccurate information. Rural Development will honor a guarantee for a loan made to an applicant who receives a guaranteed loan based on inaccurate information if the applicant was eligible to receive the guaranteed loan at the time it was made, and if the loan funds were used only for eligible loan purposes.

§ § 3555.258 - 3555.299 [Reserved]

§ 3555.300 OMB control number.

The report and recordkeeping requirements contained in this subpart are currently with the Office of Management and Budget under review and awaiting approval.

#### Subpart G - Servicing Non-Performing Loans

§ 3555.301 General servicing techniques.

In accordance with industry standards and as provided by the Agency:

(a) Prompt action. Lenders shall take prompt action to collect overdue amounts from borrowers to bring a delinquent loan current in as short a time as possible to avoid foreclosure to the extent possible and minimize losses.

(b) Evaluation of borrower. Lenders must evaluate loans and take appropriate loss mitigation actions in an effort to resolve any repayment problems and provide borrowers with the maximum opportunity to become successful homeowners.

(c) Prompt contact. In the event of default, the lender shall promptly contact the borrower within a timeframe specified by the Agency.

(d) Determine ability to cure. The lender must make a reasonable effort to obtain from the borrower information regarding the reason for default, the borrower's current financial situation and any other necessary information to evaluate the borrower's ability to cure the default and determine a feasible plan for collection, and/or alternatives to foreclosure.

(e) Communication. Before an account becomes 2 months past due and if there is no payment arrangement in place, the lender must send a certified letter to the borrower requesting an interview for the purpose of resolving the past due account.

(f) Prior to liquidation. Before an account becomes 2 months past due or before initiating liquidation, the lender must assess the physical condition of the property, determine whether it is occupied, and take necessary steps to protect the property.

(g) Maintain documentation. The lender must maintain documentation demonstrating that requirements in this subpart have been met and what steps have been taken to save a mortgage prior to making a decision to foreclose.

(h) Formal servicing plan. The lender must obtain Agency concurrence of a formal servicing plan when a borrower's account is 90 days or more delinquent and a method other than foreclosure is recommended to resolve the delinquency. Rural Development may issue a written waiver of the need for concurrence for some or all servicing actions by a lender, on a case-by-case basis, if the lender demonstrates that it no longer needs the oversight. This may be demonstrated by the lender's portfolio performance including, but not limited to, lower than average delinquency rates,

foreclosure rates, or loss claim rates. Rural Development may revoke such waiver at any time, upon notice and without appeal rights.

§ 3555.302 Protective advances.

Lenders may pay the following expenses necessary to protect the security property and charge the cost against the borrower's account.

(a) Advances for taxes and insurance. Without prior Agency concurrence, lenders may advance funds to pay past due real estate taxes, hazard and flood insurance premiums, and other related costs.

(b) Advances for costs other than taxes and insurance. Protective advances for costs other than taxes and insurance, such as emergency repairs, can be made only if the borrower cannot, or will not, obtain an additional loan or reimbursement from an insurer or the borrower has abandoned the property. The lender must determine that any repairs funded by protective advances are cost effective. Repairs funded by protective advances must be planned, performed and inspected in accordance with § 3555.202 and as further described by the Agency. The lender must obtain prior Agency concurrence or a waiver of concurrence as provided for in § 3555.301(h) before issuing protective advances under this paragraph only for protective advances of a significant amount as specified by the Agency.

§ 3555.303 Traditional servicing options.

(a) Eligibility. To be eligible for traditional servicing, all the following conditions must be met:

(1) The borrower presently occupies the property;

(2) The borrower is in default or facing imminent default for an involuntary reason. A borrower is “facing imminent default” if that borrower is current or less than 30 days past due on the mortgage obligation and is experiencing a significant reduction in income or some other hardship that will prevent him or her from making the next required payment on the mortgage during the month in which it is due. The borrower must be able to document the cause of the imminent default, which may include, but is not limited to, one or more of the following types of hardship:

(i) A reduction in or loss of income that was supporting the mortgage loan;

(ii) A change in household financial circumstances;

(3) The borrower demonstrates a reasonable ability to support repayment of the debt in the future;

(4) There are no adverse property conditions that inhibit the inhabitability or use of the property; and

(5) The borrower has not received assistance due to the submission of false information by the borrower.

(b) Servicing options. The lender must consider traditional servicing options in the following order to resolve the borrower’s default or imminent default:

(1) Repayment agreement. A repayment agreement is an informal plan lasting 3 months or less to cure short-term delinquencies.



(2) Special forbearance agreement. A special forbearance agreement is a longer-term formal plan to cure a delinquency not to exceed the equivalent of 12 months of PITI. The agreement may gradually increase monthly payments in an amount sufficient to repay the arrearage over a reasonable amount of time and/or temporarily reduce or suspend payments for a short period. If the borrower is at least 3 months delinquent, the special forbearance agreement may resume normal payments for several months followed by a loan modification.

(3) Loan modification plan. A loan modification is a permanent change in one or more of the terms of a loan that results in a payment the borrower can afford and allows the loan to be brought current.

(i) Loan modifications may include a reduction in the interest rate, even below the market rate if necessary.

(ii) Loan modifications may capitalize all or a portion of the arrearage (PITI) and/or reamortization of the balance due. Capitalization may also include foreclosure fees and costs, tax and insurance advances, past due annual fees imposed by the lender, but not late charges or lender fees.

(iii) If necessary to demonstrate repayment ability, the loan term after reamortization may be extended for up to 30 years from the date of the loan modification. However, the Rural Development guarantee is only effective 30 years from the origination date, and if the loan term is extended beyond the 30 year loan term from the date of origination, the guarantee will not apply beyond the original 30 year loan term.

(iv) The lender's lien priority cannot be adversely affected by providing a loan modification.

(c) Terms of loan note guarantee. Use of traditional servicing options does not change the terms of the loan note guarantee.

§ 3555.304 Special servicing options.

(a) General. (1) Lenders must exhaust traditional servicing options outlined in this part or have determined that use of traditional servicing options would not resolve the delinquency, prior to special servicing options. Lenders must exhaust special servicing options prior to liquidation in accordance with §§ 3555.305 or 3555.306.

(2) Lenders must obtain Agency concurrence or a waiver as provided in § 3555.301(h) before implementing any special servicing options.

(3) Use of special loan servicing does not change the terms of the loan note guarantee.

(4) Special servicing options shall be used in the order established in this section to bring the borrower's mortgage payment to income ratio as close as possible to, but not less than, 31 percent.

(b) Conditions for special servicing options. In addition to the requirements in § 3555.303(a), the following conditions apply to all special loan servicing:

(1) The borrower's total debt to income ratio following the special loan servicing must not exceed 55 percent. Prior to servicing a borrower's account with special loan servicing, the lender must verify the borrower's income and total debt.

(2) The borrower must successfully complete a trial payment plan of sufficient duration, as determined by the Agency, to demonstrate that the borrower will be able to make regularly scheduled payments as modified by the special loan servicing.

(3) Expenses related to special loan servicing including, but not limited to, title search and recording fees shall not be charged to the borrower. However, if a foreclosure was initiated and canceled prior to special loan servicing, legal fees and costs for work performed in relation to the foreclosure costs before the cancellation date may be charged to the borrower.

(4) Capitalization of late charges and lender fees is not permitted in the special loan servicing option.

(c) Extended-term loan modification. The Lender may modify the loan by reducing the interest rate to a level at or below the maximum allowable interest rate and extending the repayment term up to a maximum of 40 years from the date of loan modification.

(1) The interest rate must be fixed.

(2) The Agency may establish the maximum allowable interest rate by publishing a notice of a change in interest rate will be published as authorized in Exhibit B of subpart A of part 1810 of this chapter (RD Instruction 440.1, available in any Rural Development office) or online at: [http://www.rurdev.usda.gov/rd\\_instructions.html](http://www.rurdev.usda.gov/rd_instructions.html). If the maximum allowable interest rate has not been so established, it shall be 50 basis points greater than the most recent Freddie Mac Weekly Primary Mortgage Market Survey (PMMS) rate for 30-year fixed-rate mortgages (U.S. average), rounded to the nearest one-eighth of one percent (0.125%), as of the date the loan modification is executed.

(3) The term shall be extended only as long as is necessary to achieve the targeted mortgage payment to income ratio after the interest rate has been fixed at a level at or below the maximum allowable rate.

(4) If the targeted mortgage payment to income ratio cannot be achieved using an extended-term loan modification alone, the lender may consider a mortgage recovery advance under this section in addition to the extended-term loan modification.

(d) Mortgage recovery advance. (1) The maximum amount of a mortgage recovery advance is the sum of arrearages not to exceed 12 months of PITI, annual fees, legal fees and foreclosure costs related to a cancelled foreclosure action, and principal reduction.

(2) The maximum amount of a mortgage recovery advance is 30 percent of the unpaid principal balance as of the date of default, minus any arrearages advanced to cure the default and any foreclosure costs incurred to that point. The Agency may change the maximum amount of mortgage recovery advance by publication in the Federal Register.

(3) The principal deferment amount for a specific case shall be limited to the amount that will bring the borrower's total monthly mortgage payment to 31 percent of gross monthly income.

(4) The lender may file a claim pursuant to Subpart H of this part for reimbursement of reasonable title search and/or recording fees in connection with the promissory note and mortgage or deed-of-trust, not to exceed a maximum amount specified by the Agency.

(5) Prior to making a mortgage recovery advance, the lender must perform an escrow analysis to ensure that the payment made on behalf of the borrower accurately reflects the escrow amount required for taxes and insurance.

(6) The following terms apply to the repayment of mortgage recovery advances:

(i) The mortgage recovery advance note and subordinate mortgage or deed-of-trust shall be interest-free.

(ii) Borrowers are not required to make any monthly or periodic payments on the mortgage recovery advance note; however, borrowers may voluntarily submit partial payments without incurring any prepayment penalty.

(iii) The due date for the mortgage recovery advance note shall be the due date of the guaranteed note held by the lender, as modified by the special loan servicing. Prior to the due date on the mortgage recovery advance note, payment in full under the note is due at the earlier of the following:

(A) When the first lien mortgage and the guaranteed note are paid off; or

(B) When the borrower transfers title to the property by voluntary or involuntary means.

(iv) Repayment of all or part of the mortgage recovery advance must be remitted directly to the Agency by the borrower.

(v) The Agency will collect this Federal debt from the borrower by any available means if the mortgage recovery advance is not repaid based on the terms outlined in the promissory note and mortgage or deed-of-trust.

(7) The lender may request reimbursement from the Agency for a mortgage recovery advance. A fully supported and documented claim for reimbursement must be

submitted to the Agency within 60 days of the advance being executed by the borrower. The borrower must execute a promissory note payable to the Agency and a mortgage or deed-of-trust in recordable form perfecting a lien naming the Agency as the secured party for the amount of the mortgage recovery advance. The lender shall properly record the mortgage or deed-of-trust in the appropriate local real estate records and provide the original promissory note to the Agency.

(8) A loss claim filed by a lender will be adjusted by any amount of mortgage recovery advance reimbursed to the lender by the Agency.

§ 3555.305 Voluntary liquidation.

The lender must have exhausted the servicing options outlined in §§ 3555.302 through 3555.304 to cure the delinquency before considering voluntary liquidation. The methods of voluntary liquidation of the security property outlined in this section may be used to protect the interests of the Government. The lender must obtain prior Agency concurrence or a waiver as provided by § 3555.301(h).

(a) Eligibility. To be eligible for voluntary liquidation, the following conditions must be met:

- (1) The loan must be at least 30 days delinquent;
- (2) The default was caused by an involuntary reason; and
- (3) The borrower must presently occupy the property except in situations where the borrower does not occupy the property due to the same involuntary reason that led to the default.

(b) Pre-foreclosure or short sale. The borrower may sell the security property for a price that represents its fair market value. The sale price, less any reasonable and customary sale or closing costs incurred by the borrower, must be applied to the borrower's account.

(c) Deed in lieu of foreclosure. The lender may accept a deed in lieu of foreclosure if it will result in a lesser loss claim than if foreclosure occurs.

(d) Offer by junior lienholder. If a junior lienholder makes an offer in the amount of at least the anticipated net recovery value, as calculated in accordance with § 3555.353, the lender may assign the note and mortgage to the junior lienholder.

(e) Other methods of voluntary liquidation. The lender may propose other methods of voluntary liquidation that are consistent with this section if the lender fully documents how the proposal will result in a savings to the Government.

#### § 3555.306 Liquidation.

(a) General. (1) When a lender determines that a borrower is unable or unwilling to meet loan obligations with servicing options under this subpart, the lender must accelerate the guaranteed loan and, if necessary, foreclose.

(2) Prior to acceleration the lender must have advised the borrower, in writing, of available foreclosure avoidance options and the borrower must have failed to request such options.

(3) The lender must accelerate the guaranteed loan, with a demand letter, when the account is three scheduled payments past due unless there is a reasonable prospect of resolving the delinquency through another method.

(4) The borrower is responsible for all expenses associated with liquidation and acquisition.

(b) Foreclosure. (1) The lender must initiate foreclosure within 90 calendar days of the decision to liquidate unless Federal, State, or local law requires that foreclosure action be delayed. When there is a legal delay (such as bankruptcy), foreclosure must be initiated within 90 calendar days after it becomes possible to do so. Foreclosure initiation begins with the first public action required by law such as filing a complaint or petition, recording a notice of default, or publication of a notice of sale.

(2) Lenders must exercise due diligence in completing the liquidation process to ensure the foreclosure is cost effective, expeditious, and completed in an efficient manner, as otherwise provided by the Agency. The lender must choose the foreclosure method representing the best interest of the Federal Government.

(3) The lender's decision to bid at foreclosure and any bid amount will be based upon the property value, whether the property value is sufficient to cover the existing debt and incurred costs, and any potential to recover a deficiency. The lender will encourage third party bidding at a foreclosure sale when the total debt, including the cost of acquiring, managing and disposing of the property, if acquired, is greater than the gross proceeds expected from a foreclosure sale at market value.

(c) Reinstatement of accounts. Unless State law imposes other requirements, the lender may reinstate an accelerated account only if the borrower:



(1) Pays, or makes acceptable arrangements to pay, all past-due amounts, any protective advances, and any foreclosure-related costs incurred by the lender; and

(2) Has the ability to continue making scheduled payments on the guaranteed loan.

(d) Bankruptcy. (1) When a borrower files a petition in bankruptcy, the lender must suspend collection and foreclosure actions in accordance with Title 11 of the United States Code.

(2) The lender may accept conveyance of security property by the trustee in the bankruptcy, or the borrower, if the bankruptcy court has approved the transaction, and the lender will acquire title free of all liens and encumbrances except the lender's liens.

(3) Whenever possible after the borrower has filed for protection under Chapter 7 of Title 11 of the United States Code, a reaffirmation agreement will be signed by the borrower and approved by the bankruptcy court prior to discharge, if the lender and the borrower decide to continue with the loan.

(4) The lender must protect the guaranteed loan debt and all collateral securing the loan in bankruptcy proceedings.

(5) The lender can include principal and interest lost as a result of bankruptcy proceedings in any claim filed in accordance with § 3555.354.

(e) Maintain condition of security property. The lender must make reasonable and prudent efforts to ensure that the condition of the security property is maintained during any liquidation, acquisition, and sale of the property. These efforts include, but are not limited to, periodic inspections, performing necessary repairs, winterization, securing the property, removing debris, yard maintenance and ensuring the continuance of property

insurance. The lender must identify, determine the cause, and document any environmental hazard affecting the value of the security property. The lender must retain a record of all efforts to maintain the condition of the security property.

(f) Managing and disposing of REO property. Lenders will expeditiously gain possession of the REO property in a manner designed to ensure maximum recovery as follows.

(1) The lender must prepare and maintain a disposition plan on all acquired properties. The lender will submit the property disposition plan and any subsequent changes for Agency concurrence in a timely manner as specified by the Agency. The lender may obtain a waiver of the concurrence requirement as provided for in § 355.5301(h). The plan will include the proposed method for sale of the property, the estimated value based on an appraisal, minimum sale price, itemized estimated costs of the sale, and any other information that could impact the amount of loss on the loan.

(2) The lender will make all reasonable efforts to sell the property within 9 months from the later of either the foreclosure sale or expiration of any redemption period. The Agency may grant an extension of the permissible marketing period in limited circumstances including, but not limited to, when a separate legal action is necessary to gain possession of the property following foreclosure or when the lender has or is in final negotiation for a firm purchase agreement. If the property is on American Indian restricted land, an additional 3 month marketing period is permitted.

(3) The lender must notify the Agency when the property has not been sold within 30 days of the expiration of the permissible marketing period. If the REO remains unsold at the end of the permissible marketing period, the Agency will order a liquidation value

appraisal and apply an acquisition and management resale factor to estimate holding and disposition cost. Interest expenses accrued beyond 90 days of the foreclosure sale date or expiration of any redemption period, whichever is later, will be the responsibility of the lender and not covered by the guarantee.

(g) Debt settlement reporting. The lender must report to the IRS and all national credit reporting repositories any debt settled through liquidation.

§ 3555.307 Assistance in natural disasters.

(a) Policy. Servicers must utilize general procedures available under this subpart for servicing borrowers affected by natural disasters, as supplemented by Rural Development, to minimize delinquencies and avoid foreclosure.

(b) Evaluating the damage. Servicers are expected to inspect a security property whenever they have reason to believe the property has been damaged.

(c) Special relief measures. The servicer must evaluate on an individual case basis a mortgage that is (or becomes) seriously delinquent as the result of the borrower's incurring extraordinary damages or expenses related to the natural disaster. The servicer should document its individual mortgage file regarding all servicing actions taken during this time period. The lender must consider all special relief alternatives for disaster assistance available to the borrower prior to suspending collection and foreclosure activities. Servicing actions suspended as a result of the natural disaster will expire 90 days from the declaration date of the natural disaster, unless otherwise extended by the Agency.

(d) Insurance claim settlements. Prior to release of hazard insurance proceeds because of damage caused by a natural disaster, servicers must complete a cost and benefit analysis on a case-by-case basis to determine if the property can be repaired or rebuilt. The servicer's actions must be based on the status of the mortgage, the amount of insurance proceeds, and the length of time required repairing or reconstructing the property, and the market conditions in the area. If the property will not be repaired or rebuilt, the insurance proceeds must be applied to the unpaid principal loan balance.

§§ 3555.308 - 3555.349 [Reserved]

§ 3555.350 OMB control number.

The report and recordkeeping requirements contained in this subpart are currently with the Office of Management and Budget under review and awaiting approval.

Subpart H - Collecting on the Guarantee

§ 3555.351 Loan guarantee limits.

(a) Original loan amount. For the purposes of this section, the term "Original Loan Amount" means the original promissory note amount minus any loans funds not actually disbursed to the borrower or on behalf of the borrower at the time the SFHGLP loan was made or thereafter.

(b) Maximum loss payment. The maximum payment for a loss sustained by the lender under the SFHGLP is the lesser of:

- (1) 90 percent of the Original Loan Amount; or
- (2) 100 percent of any loss equal to or less than 35 percent of the Original Loan Amount plus 85 percent of any remaining loss up to 65 percent of the Original Loan Amount.

§ 3555.352    Loss covered by the guarantee.

Subject to § 3555.351, the loss claim payment will be calculated as the difference between the Total Indebtedness on the loan and the Net Recovery Value calculated according to § 3555.353. The Total Indebtedness on the loan includes:

- (a) Principal balance. The unpaid principal balance;
- (b) Accrued interest. Accrued interest at the guaranteed loan note rate from the last day interest was paid by the borrower to the settlement date, as defined at § 3555.10;
- (c) Additional interest. Additional interest on the unsatisfied principal accrued from the settlement date to the date the claim is paid, but not more than 90 days from the settlement date;
- (d) Protective advances. Principal and interest for protective advances, as described in § 3555.303; and
- (e) Liquidation costs. Reasonable and customary liquidation costs, such as attorney fees and foreclosure costs. Annual fees advanced by the lender to the Agency are ineligible for reimbursement when calculating the loss payment, as otherwise provided by the Agency.

§ 3555.353 Net recovery value.

The net recovery value of the property is determined differently for properties that have been sold than for properties that remain in the lender's inventory at the time the loss claim is filed.

(a) Actual net recovery value. For a property that has been sold when a loss claim is filed, net recovery value is calculated as follows:

(1) The proceeds from the sale plus any other amounts recovered, minus

(2) The amount of actual liquidation and disposition costs provided those costs are reasonable and customary for the area. Costs incurred by in-house staff may not be included.

(b) Anticipated net recovery value. For a property that has not sold when a loss claim is filed, net recovery value is calculated as follows:

(1) The value of the property as determined by an Agency liquidation appraisal.

The value should be determined as if the property would be sold without the market exposure it would ordinarily receive in a normal transaction, or within 90 days, minus;

(2) The amount of actual liquidation expenses and estimated disposition costs that are reasonable and customary for the area. Costs incurred by in-house staff may not be included.

(i) Actual liquidation expenses are the amount of attorney fees and costs, etc. incurred to acquire title to the property.

(ii) Estimated disposition costs are calculated by Rural Development using reasonable and customary cost factors appropriate for the area (available in any Rural Development office).

§ 3555.354 Loss claim procedures.

Rural Development may offer authorized lenders a web-based automated system to calculate, submit or update a loss claim request and/or future recovery subject to the requirements of § 3555.356. Manual paper loss claims may continue to be submitted by some lenders. Lenders must make a thorough review of all receipts and expenses prior to submitting a loss claim request. Supplemental adjustments to the initial claim may be considered, as provided by the Agency.

(a) Sold property. For property that has been sold, the lender must submit a loss claim within 45 calendar days of the sale. Late claims made beyond this period of time may be rejected or reduced by Rural Development. Instructions and forms may be obtained from Rural Development.

(b) REO. If the property has not been sold, the lender must take the following steps:

(1) Notify Rural Development that the property has not been sold so that Rural Development may request an appraisal.

(i) If the property is not located on American Indian restricted land, the lender must notify Rural Development if the property has not been sold within 9 months of foreclosure, or from the end of any applicable redemption period, whichever is later.

(ii) If the property is located on American Indian restricted land, the lender must notify Rural Development if the property has not been sold within 12 months of foreclosure, or from the end of any redemption period, whichever is later.

(2) Upon notification that the property has not been sold, Rural Development will obtain an appraisal at the Agency's expense and provide a liquidation value to the lender. The lender must submit a loss claim within 30 calendar days of receiving the liquidation value from Rural Development. Late claims made beyond this period of time will be rejected.

(c) Deficiency judgments. The lender must enforce any judgment for which there are current prospects of collection before submitting a loss claim, and amounts collected must be applied against the outstanding debt. Rural Development will process the loss claim if there are no current prospects for collection.

§ 3555.355 Reducing or denying the claim.

(a) Determination of loss payment. Subject to the requirements of § 3555.108, if Rural Development determines that the amount of the loss was increased due to the lender's failure to comply with the conditions of the Loan Note Guarantee, the Agency may reduce or deny any loss claim by the portion of the loss determined was caused by the lender's action or failure to act. The circumstances under which loss claims may be denied or reduced include, but are not limited to, the following lender actions:

(1) Failure to adhere to required servicing and liquidation procedures as set forth in Agency regulations and guidance, including the payment of real estate taxes or hazard insurance when due;

(2) Failure to report defaulted loans to Rural Development within required timeframes;



(3) Failure to ensure that the security property is adequately maintained during liquidation;

(4) Delay in filing a loss claim;

(5) Claiming unauthorized expenses;

(6) Providing unauthorized assistance;

(7) Failure to obtain the required security or maintain the security position;

(8) Violating usury laws;

(9) Negligence, gross negligence or misrepresentation; or

(10) Committing fraud, or failing to report knowledge of fraud or false information.

(b) Disputes. If the lender disputes the loss claim amount determined by Rural Development, Rural Development will pay the undisputed portion of the loss claim, and the lender may appeal the decision in accordance with § 3555.4.

§ 3555.356 Future recovery.

The lender must notify the Agency upon sale of an REO property. If the lender recovers additional funds after the loss claim has been paid, the proceeds will be distributed so that the total loss to the Government is equivalent to the loss that would have been incurred had the recovered amount been included in the initial loss calculation.

§§ 3555.357 - 3555.399 [Reserved]

§ 3555.400    OMB control number.

The report and recordkeeping requirements contained in this subpart are currently with the Office of Management and Budget under review and awaiting approval.

\_\_\_\_\_ November 26, 2013\_\_\_\_\_

DOUGLAS J. O' BRIEN Date

Acting Under Secretary

Rural Development

\_\_\_\_\_ November 26, 2013\_\_\_\_\_

MICHAEL SCUSE Date

Acting Under Secretary

Farm and Foreign Agricultural Services

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